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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9805]

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Guidance Under Section 355(e) Regarding Predecessors, Successors, and Limitation on Gain Recognition; Guidance Under Section 355(f)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that provide guidance regarding the distribution by a distributing corporation of stock or securities of a controlled corporation without the recognition of income, gain, or loss. The temporary regulations provide guidance in determining whether a corporation is a predecessor or successor of a distributing or controlled corporation for purposes of the exception under section 355(e) of the Internal Revenue Code (Code) to the nonrecognition treatment afforded qualifying distributions, and they provide certain limitations on the recognition of gain in certain cases involving a predecessor of a distributing corporation. The temporary regulations also provide rules regarding the extent to which section 355(f) of the Code causes a distributing corporation (and in certain cases its shareholders) to recognize income or gain on the distribution of stock or securities of a controlled corporation. These temporary regulations affect corporations that distribute the stock or securities of controlled corporations and the shareholders or security holders of those distributing corporations. The text of these temporary regulations also serves as the

text of the proposed regulations in the related notice of proposed rulemaking (REG-140328-15) set forth in the Proposed Rules section in this issue of the **Federal Register**.

DATES: Effective date: These temporary regulations are effective on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Applicability date: For dates of applicability see §1.355-8T(i) and (j).

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SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

1. Overview

On November 22, 2004, the Department of the Treasury (Treasury Department) and the IRS published in the **Federal Register** (69 FR 67873) a notice of proposed rulemaking (REG-145535-02) containing proposed regulations under section 355(e)(4)(D) of the Code (the proposed regulations). After considering the comments received on the proposed regulations and taking into account subsequently issued guidance as described in part 3. of this preamble, the Treasury Department and the IRS are issuing temporary regulations that adopt the proposed regulations with significant modifications based on the comments received on the proposed regulations. The temporary regulations also serve as the text of new proposed regulations in the related notice of proposed rulemaking (REG-140328-15) published in the Proposed Rules section in this issue of the **Federal Register**.

The temporary regulations amend 26 CFR part 1 under section 355 to provide

necessary guidance under section 355(e)(4)(D) regarding the identity of predecessor and successor corporations of distributing and controlled corporations and to enable taxpayers to utilize the benefit of certain gain limitation rules. The temporary regulations also provide guidance regarding the extent to which section 355(f) precludes the application of section 355 to certain distributions and exchanges between members of an affiliated group. Finally, the regulations provide guidance regarding the application of section 336(e) to certain distributions of controlled stock to which section 355(e) applies.

A. Section 355 in general

Section 355(a) generally provides that if a distributing corporation (Distributing) distributes stock or securities of a controlled corporation (Controlled) to Distributing's shareholders or security holders and certain requirements are met, then no gain or loss is recognized by (and no amount is includible in the income of) Distributing's shareholders or security holders upon their receipt of the Controlled stock. Section 355(c) generally provides that Distributing does not recognize gain or loss on any distribution of qualified property to which section 355 (or so much of section 356 as relates to section 355) applies. Similar rules under section 361(c) apply in the case of a divisive reorganization under section 368(a)(1)(D) (a divisive D reorganization). Controlled stock or securities are qualified property under section 355(c)(2)(B) (or section 361(c)(2)(B)(ii) in the case of a divisive D reorganization), unless certain exceptions apply.

B. Sections 355(e) and (f)

One exception to treating Controlled stock or securities as qualified property is provided under section 355(e), which was enacted as part of the Taxpayer Relief Act of 1997, Public Law 105-34, section 1012(a), 111 Stat. 788. Under section 355(e), stock or securities of Controlled generally will not be treated as qualified property under sections 355(c)(2) or 361(c)(2) if the stock or securities are distributed as part of a plan or series of related transactions (a Plan) pursuant to which one or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the stock of Distributing or Controlled (a Planned 50-percent Acquisition). Section 1.355-7 of the Income Tax Regulations provides additional guidance on the meaning of a Plan.

Under section 355(e)(2)(C), the existence of a purported Plan that includes a Planned 50-percent Acquisition will not prevent Controlled stock or securities from being treated as qualified property for purposes of section 355(c)(2) or section 361(c)(2) if, immediately after the completion of such Plan, Distributing and each Controlled are members of a single affiliated group, as defined in section 1504 without regard to section 1504(b) (an Expanded Affiliated Group or EAG). As a result, section 355(e) generally does not apply to a distribution between members of the same EAG unless the distribution precedes a distribution of Controlled stock or securities outside of the EAG (an External Distribution) so that Controlled and Distributing are not members of the same EAG after completion of the Plan.

Section 355(f) provides a special rule that applies to certain distributions between certain related corporations that do not qualify for the exception from section 355(e) under section 355(e)(2)(C). In particular, section 355(f) provides that, except as provided in regulations, section 355 (or so much of section 356 as relates to section

355) does not apply to the distribution of stock from one member of an affiliated group (as defined in section 1504(a)) to another member of the group if the distribution is part of a Plan that includes a Planned 50-percent Acquisition and is not described in section 355(e)(2)(C). For example, assume that a Planned 50-percent Acquisition of stock of a corporation (a Higher-Tier Distributing) that is the common parent of an affiliated group, as defined in section 1504(a), occurs when the Higher-Tier Distributing owns all of the stock of a subsidiary member (a Lower-Tier Distributing), which in turn owns all of the stock of Controlled (also a member of the affiliated group). Under the Plan, the Lower-Tier Distributing distributes Controlled stock to the Higher-Tier Distributing (an Internal Distribution), and the Higher-Tier Distributing then distributes the Controlled stock in an External Distribution. Under these facts, section 355(e) would apply to the Internal Distribution of all of Controlled's stock by the Lower-Tier Distributing to the Higher-Tier Distributing because the distribution is part of a Plan (after application of any exceptions to section 355(e), including section 355(e)(2)(C)). However, section 355(f) provides that section 355 (or so much of section 356 as applies to section 355) would not apply to such an Internal Distribution. Therefore, the Internal Distribution would be taxable to the Lower-Tier Distributing under section 311 and to the Higher-Tier Distributing under section 301 (subject to any available dividends received deduction and section 1059) or subject to the special rules of §1.1502-13(f) for distributions between members of the same consolidated group.

Without the application of section 355(f), the Lower-Tier Distributing would recognize any gain in the Controlled stock by reason of section 355(e) (section 355(e) gain) in the Internal Distribution, but the Higher-Tier Distributing would be afforded

nonrecognition treatment under section 355(a) on the receipt of Controlled stock. As a result, the Higher-Tier Distributing would not take a fair market value basis in the Controlled stock under section 301(d), but a basis determined under section 358(g), despite the Lower-Tier Distributing's recognition of section 355(e) gain. The Higher-Tier Distributing would also likely recognize additional section 355(e) gain on the subsequent External Distribution of the Controlled stock. Section 355(f) is intended to provide a benefit to such an affiliated group by effectively ensuring that the group recognizes section 355(e) gain only once at the lowest-tier Distributing, rather than at multiple levels. In addition, application of section 355(f) may eliminate duplicated loss, in some cases.

Section 355(e)(3)(B) provides that, if the assets of Distributing or any Controlled are acquired by a successor corporation in a reorganization under section 368(a)(1)(A), (C), or (D), or any other transaction specified in regulations by the Secretary, the shareholders (immediately before the acquisition) of the corporation acquiring such assets are treated as acquiring stock in the corporation from which the assets were acquired.

Section 355(e)(4)(D) provides that, for purposes of section 355(e), any reference to Controlled or Distributing includes a reference to any predecessor or successor of such corporation. As a result, Controlled stock or securities generally will not be treated as qualified property under section 355(c)(2) or 361(c)(2) if there is a Planned 50-percent Acquisition of the stock of a predecessor or successor of Distributing or Controlled.

2. Summary of Proposed Regulations

Section 355(e) does not provide a definition of a predecessor or successor of Distributing or Controlled. The proposed regulations generally defined the terms predecessor and successor for purposes of section 355(e) and provided guidance regarding the acquisition or deemed acquisition of the stock of predecessors of Distributing and certain other acquisitions. As more fully described in part 2.E. of this preamble, the proposed regulations also limited Distributing's recognition of gain in two cases and provided an overall gain limitation. Parts 2.A. through 2.F. of this preamble describe the proposed regulations, which the temporary regulations largely adopt with the modifications described in part 3. of this preamble.

A. Predecessor of Distributing

The preamble to the proposed regulations stated that the definition of a Predecessor of Distributing (a POD) in those regulations was intended to reflect the fact that section 355(e) generally denies tax-free treatment under sections 355(c)(1) and 361(c)(1) if there is a division of Distributing's assets to which section 355(a) applies that is coupled with a Planned 50-percent Acquisition of Distributing or Controlled. The proposed regulations attempted to provide a similar result in cases in which the ownership of a POD's assets (rather than those of Distributing) would otherwise be divided tax-free as part of a Plan that included a Planned 50-percent Acquisition of a POD or Distributing.

The proposed regulations generally defined a POD as a corporation that transferred its property in a transaction to which section 381(a) applies (section 381 transaction) to Distributing (a combining transfer) but only if Distributing then transferred some, but not all, of the property acquired in the combining transfer to Controlled in a

transferred basis transaction before the distribution (a separating transfer). The definition was slightly different if Controlled stock was an asset transferred in the combining transfer. In addition, under the proposed regulations, no corporation could have been a predecessor of a POD.

In addition, the proposed regulations provided three operating rules relating to the determination of predecessor status. The first was a substitute asset rule that prevented a corporation from avoiding treatment as a POD simply because property received by Distributing in a combining transfer (or by Controlled in a separating transfer) was transferred by Distributing before the separating transfer (or by Controlled before the distribution) in exchange for other property in a nonrecognition transaction. The second rule provided that the transferor corporation and resulting corporation in a reorganization under section 368(a)(1)(F) (an F reorganization) would be treated as the same entity for purposes of determining whether a corporation is a POD or a Predecessor of Controlled (POC), as described in part 2.B. of this preamble. Without such a rule, a corporation could circumvent the proposed regulations by engaging in an F reorganization, because the proposed regulations did not take into account predecessors of a POD or POC. The third rule provided that there may be more than one POD, for example, if multiple corporations merged directly with and into Distributing in distinct transactions to which section 381 applied.

Under the proposed regulations, the definition of a POD was not tied to the existence of a Plan. Accordingly, a combining transfer and a separating transfer would be taken into account in identifying a POD even if neither transfer was part of a Plan; as a result, taxpayers would have been required to track the assets of any potential POD

for an unlimited period prior to the distribution. In addition, once a POD had been identified, it would have been necessary to determine whether the distribution and any acquisitions (deemed or actual) of stock of the POD were part of a Plan, although the proposed regulations included no guidance relating to whether acquisitions of the stock of a POD and the distribution were part of a Plan.

B. Predecessor of Controlled

The proposed regulations defined a POC as a corporation that transferred its assets to Controlled in a section 381 transaction before the distribution. However, whether a corporation was a POC was only taken into account for very limited purposes: (1) The definition of a POD, (2) the gain limitation rules described in part 2.E. of this preamble, and (3) the application of section 355(e)(2)(C), which is described in part 2.F. of this preamble. Other than for those limited purposes, a corporation would not be a POC under the proposed regulations. Further, no corporation could have been a predecessor of a POC.

C. Successor of Distributing and Controlled

The proposed regulations defined a Successor of Distributing or Controlled as a corporation to which Distributing or Controlled, respectively, transferred its assets in a section 381 transaction after the distribution (a Successor Transaction). If, after the distribution, Distributing transferred its assets to a Successor in a Successor Transaction, the proposed regulations provided that the shareholders of the Successor immediately before the transaction would be deemed to acquire Distributing stock (and stock of any POD) in the Successor Transaction. Subsequent acquisitions of stock of the Successor would be treated as acquisitions of Distributing (and any PODs).

D. Special rules for measuring acquisitions

Under the proposed regulations, the determination of whether there was a Planned 50-percent Acquisition was made separately with respect to Distributing and the POD. Therefore, Distributing may have been required to recognize section 355(e) gain if there was a Planned 50-percent Acquisition of a POD, but not of Distributing, and vice versa.

The proposed regulations provided special rules to determine whether there had been an acquisition of the stock of a POD in connection with and after a combining transfer from a POD to Distributing. Consistent with section 355(e)(3)(B), the proposed regulations provided that each person that owned an interest in Distributing immediately before the combining transfer would be treated as acquiring stock of the POD in the transaction. For example, if Distributing acquired the assets of a POD in a statutory merger qualifying as a reorganization under section 368(a)(1)(A) (an A reorganization), and individual A owned stock of Distributing immediately before the merger, A would be treated as acquiring stock of the POD in the transaction. In addition, an acquisition of Distributing that occurred after Distributing's combination with a POD would be treated not only as an acquisition of Distributing, but also as an acquisition of the POD. For example, if Distributing acquired the assets of a POD in a statutory merger qualifying as an A reorganization and, after the merger, individual B acquired stock of Distributing, B would be treated as acquiring not only stock of Distributing, but also stock of the POD. Similar rules applied with respect to Controlled except that there was no provision for a deemed acquisition of the stock of a POC because such acquisitions were of no consequence under the proposed regulations.

In addition, the proposed regulations provided that acquisitions of the stock of a corporation and its Successors would be combined to determine whether there had been a Planned 50-percent Acquisition of the corporation. For example, planned acquisitions of the stock of a POD, Distributing, and Distributing's Successors would be combined to determine whether there had been a Planned 50-percent Acquisition of the POD. Similarly, planned acquisitions of the stock of Distributing and its Successors would be combined to determine whether there had been a Planned 50-percent Acquisition of Distributing. In addition, planned acquisitions of the stock of Controlled and its Successors would be combined to determine whether there had been a Planned 50-percent Acquisition of Controlled.

E. Limitations on gain recognition

Generally, if there is a Planned 50-percent Acquisition of Distributing (or a POD), Controlled, or their Successors, then section 355(e) requires Distributing to recognize the full amount of the built-in gain in the Controlled stock on the date of the distribution under section 355(c)(2) or section 361(c)(2), as applicable. The proposed regulations provided two gain limitation rules limiting the amount of gain that Distributing must recognize in certain cases in which there was a POD and a third gain limitation rule providing an overall limitation on Distributing's gain.

The first gain limitation rule applied when there was a Planned 50-percent Acquisition of one or more PODs. In those cases, the calculation of the section 355(e) gain focused on assets of the POD(s) that were transferred to Controlled and any Controlled stock transferred by the POD(s) to Distributing. Specifically, the proposed regulations limited the section 355(e) gain recognized by Distributing to the amount of

gain, if any, that any PODs would have recognized if, immediately before the distribution each POD had (1) transferred the property that was transferred to Controlled (and any stock of Controlled that the POD transferred to Distributing) to a newly-formed, wholly-owned corporation solely for stock of such corporation in an exchange to which section 351 applied (section 351 exchange), and (2) then sold the stock of that corporation to an unrelated person in exchange for cash equal to its fair market value. In applying this first gain limitation rule, the proposed regulations provided four operating rules. The first operating rule was a substitute asset rule (similar to that described in part 2.A. of this preamble) that applied if property received by Distributing in a combining transfer had been exchanged tax-free. In such case, the property Distributing received in the exchange would be treated as property received in the combining transfer. The second operating rule provided that (other than Controlled stock) the only property taken into account for purposes of the first gain limitation rule would be property that was transferred to Controlled in the separating transfer (or a substitute asset received in a tax-free exchange for property received in the separating transfer) and held by Controlled at the time of the distribution. Under the third operating rule, the basis and value of the property (other than Controlled stock) would be determined as of the date of the distribution. The fourth operating rule provided that the basis and value of any Controlled stock that the POD transferred to Distributing would be measured on the date of the combining transfer.

The second gain limitation rule applied if a section 381 transaction (for example, an A reorganization of a POD into Distributing) caused a Planned 50-percent Acquisition of Distributing stock. Under those circumstances, the second gain limitation

rule effectively limited the amount of section 355(e) gain that Distributing would recognize to the excess of the amount described in section 355(c)(2) or section 361(c)(2), as applicable, over any section 355(e) gain that Distributing would have been required to recognize if there had been a Planned 50-percent Acquisition of one or more PODs (but not Distributing). The section 355(e) gain computed on the hypothetical Planned 50-percent Acquisition of Distributing would take into account the first gain limitation rule.

The third gain limitation rule was an overall limitation on gain recognition. This rule limited the total amount of section 355(e) gain that could be recognized by Distributing as a result of the distribution to the amount of the built-in gain in the Controlled stock that, without regard to the first and second gain limitation rules, would be taken into account under section 355(c)(2) or section 361(c)(2).

F. Special rule for affiliated groups

As described in part 1.B. of this preamble, section 355(e)(2)(C) provides that section 355(e) does not apply to a distribution between members of an EAG if, immediately after completion of the Plan, Distributing and Controlled both remain members of the same EAG. The proposed regulations included a special rule that would rationalize the application of section 355(e)(2)(C) within an EAG, following a section 381 transaction. The proposed regulations provided that, for purposes of section 355(e)(2)(C), a POD or POC that was a member of the same EAG as Distributing or Controlled (as relevant) at the time of the section 381 transaction would be treated as continuing in existence within the EAG following its transfer of property to Distributing or Controlled in the section 381 transaction. Similarly, Distributing or

Controlled would be treated as continuing in existence following a transfer of property to a Successor that was a member of the same EAG. Without this rule, for example, because a POD that was a historic member of the EAG would not continue to exist for Federal income tax purposes after transferring property to Distributing in a combining transfer, section 355(e)(2)(C) would not prevent section 355(e) from applying to a Planned 50-percent Acquisition of the stock of a POD, even if Distributing and Controlled remained members of the same EAG immediately after completion of the Plan.

3. Summary of Comments and Modifications Adopted in the Temporary Regulations

The Treasury Department and the IRS received formal and informal comments regarding the proposed regulations. The comments and modifications to the proposed regulations adopted in the temporary regulations are discussed here. The temporary regulations retain many of the rules of the proposed regulations; however, in response to comments, the temporary regulations modify some provisions and add new provisions, as discussed in parts 3.A. through 3.D. of this preamble. In addition, the temporary regulations include certain non-substantive modifications to the organization of the rules of the proposed regulations.

A. Comments regarding definition of POD

i. Scope of Definition of a POD and Application of §1.355-7 Plan Rules

The Treasury Department and the IRS received a comment regarding the narrow scope of the definition of a POD in the proposed regulations. Under the proposed regulations, the definition of a POD was limited to a corporation that, before the distribution, transferred property to Distributing in a section 381 transaction. Further,

following the transfer from a POD, Distributing must have transferred some (but not all) of the acquired property to Controlled (or to a POC, as described below), and the basis of such property immediately after the transfer to Controlled (or a POC) must have been determined in whole or in part by reference to the basis of the property in the hands of Distributing immediately before the transfer. The commenter noted that the results contemplated by the definition of a POD of the proposed regulations (the tax-free separation of the POD's assets in the distribution, coupled with a potential 50-percent acquisition of the POD's stock) could be effectively replicated in a manner that would circumvent that definition and thereby avoid the application of section 355(e) in substantially similar transactions. For example, assume that corporation D2 owns 100 percent of both classes (voting class A and voting class B) of corporation D1's stock, and D1 owns all of the stock of corporation C. The three corporations together file a consolidated return (the D2 group). Assume that the following steps occur as part of a Plan: D2 acquires all of the stock of unrelated corporation P in exchange for 10 percent of D2's only class of outstanding stock in a reorganization under section 368(a)(1)(B). After joining the D2 group, P transfers an asset to D1 for less than 20 percent of D1's voting class A stock in a section 351 exchange by application of §1.1502-34. D1 then transfers the asset to C and distributes all the C stock with respect to its voting class B stock to D2 in a transaction qualifying under section 355(a). D2 in turn distributes all the C stock to its shareholders in a transaction qualifying under section 355(a). In such a case, P's assets have been divided tax-free as a result of the distribution of C stock, and P has undergone a 50-percent acquisition of its stock, but section 355(e) would not

apply because P did not engage in a section 381 transaction, although all steps occurred under a Plan.

Commenters also expressed concern that the definition of a POD in the proposed regulations would apply without regard to whether the combining transfer or separating transfer were part of a Plan. These commenters further noted that the Plan rules of §1.355-7, which were published after the proposed regulations, did not provide express guidance regarding their application in cases involving an acquisition of a POD's stock that could implicate section 355(e). The commenters recommended that the proposed regulations be modified to include: (1) A rule stating that a corporation can satisfy the definition of a POD only if both the combining transfer and the separating transfer are part of a Plan, and (2) express guidance regarding the application of the §1.355-7 Plan rules in cases involving an acquisition of a POD's stock. The comments indicated that, absent the requirement that the combining transfer and the separating transfer both be part of a Plan, there could be uncertainty as to whether section 355(e) would apply to the acquisition of a potential POD if there is no Plan in existence at the time of the section 381 transaction. Further, this uncertainty would burden taxpayers by requiring assets acquired by Distributing in any section 381 transaction at any time to be tracked through the date of the distribution without knowing whether section 355(e) would apply.

The Treasury Department and the IRS have determined that the normal construct of the Plan rules in §1.355-7 generally should apply to acquisitions of POD stock (as well as to acquisitions of the stock of Distributing, Controlled, and their Successors). Accordingly, the temporary regulations provide a general rule that

references in §1.355-7 to Distributing or Controlled are treated as references to a POD, POC, or Successor of Distributing or Controlled, as the context may require. Further, a reference to a distribution generally includes a reference to a distribution and other related pre-distribution transactions that together effect a division of the assets of a POD. However, special rules apply with regard to the actions taken into account in determining whether a 50-percent acquisition of a POD occurs as part of Plan. Although a 50-percent acquisition of a POD may occur contemporaneously with a distribution made by Distributing, the acquisition and distribution might occur as part of a Plan of the POD, but without the participation (or even the knowledge) of Distributing. Because Distributing would be the corporation that could recognize section 355(e) gain, the Treasury Department and the IRS have determined that it is not appropriate to apply the rules of §1.355-7 by imputing to Distributing the actions of a POD or its shareholders. Accordingly, these temporary regulations provide that any agreement, understanding, arrangement, or substantial negotiations with regard to the acquisition of a POD is analyzed under §1.355-7 by taking into account the actions of officers or directors of Distributing or Controlled, controlling shareholders (as defined in §1.355-7(h)(3)) of Distributing or Controlled, or a person acting with the implicit or explicit permission of one of those parties. The actions of officers or directors of a POD and other parties that might be relevant with regard to an analysis under §1.355-7 if the POD were an actual Distributing are not considered unless those actions otherwise would be examined under the preceding sentence (for example, if a POD or its shareholder is a controlling shareholder of Distributing).

In addition, the Treasury Department and the IRS agree with the comment that

the definition of a POD in the proposed regulations, with its exclusive application to transferors in section 381 transactions, did not adequately address section 355(e) policy concerns regarding the use of section 355 to facilitate tax-free dispositions of assets. The Treasury Department and the IRS also agree with commenters that the existence of a Plan should be relevant to the determination of whether a corporation is a POD, to minimize the burden of tracking a corporation's assets prior to the distribution. Therefore, as described in the following paragraphs, the modified definition of a POD contained in the temporary regulations takes into account both of these comments.

ii. Modifications to Definition of a POD

a. Synthetic spin-off analysis

Study by the Treasury Department and the IRS arising from consideration of the comments received on the proposed regulations has led to the identification of a variety of pre-distribution transactions that taxpayers could use to achieve results substantially similar to a combining transfer and separating transfer. For example, as described in part 3.A.i. of this preamble, a corporation could transfer some, but not all, of its assets to Distributing in a section 351 exchange, with those assets ultimately being held by Controlled when its stock is distributed by Distributing. However, under the proposed regulations, POD status would not attach to the transferor because the division of the transferor's assets would be accomplished using a section 351 exchange and not in a section 381 transaction (that is, a combining transfer).

The Treasury Department and the IRS have reviewed the major goal of the proposed regulations, as discussed at part 2.A. of this preamble: to apply section 355(e) in cases in which, as part of a Plan, a tax-free division of the ownership of the

POD's assets would otherwise be achieved through the use of a section 355 distribution. Although not discussed in depth in the preamble of the proposed regulations, the overarching theory was to apply section 355(e) to a section 355 distribution if, as part of a Plan, some of the assets of a POD were transferred to Controlled without full recognition of gain, and the distribution accomplished a division of the POD's assets. The Treasury Department and the IRS viewed (and continue to view) this type of transaction as a vehicle for achieving, as a result of the distribution of Controlled stock, the tax-free separation of the assets that the POD transferred to Distributing that are further transferred to Controlled (a synthetic spin-off). The POD might have separated those assets in a divisive D reorganization, without the intervention of Distributing. However, in that case, section 355(e) may have applied to the section 355 distribution, whereas, absent treatment as a POD, a synthetic spin-off of the POD's assets would not be subject to section 355(e).

The proposed regulations defined a POD narrowly, so that a corporation that transferred some of its assets to Controlled would be a POD only if it first transferred those assets to Distributing in a section 381 transaction. To achieve the goal of applying section 355(e) to synthetic spin-offs more effectively, these temporary regulations have both broadened and limited the scope of the definition of a POD. As discussed in greater detail in part 3.A.ii.b. of this preamble, the temporary regulations eliminate the formalistic requirements of a combining transfer followed by a separating transfer and generally identify as a POD any corporation whose assets are divided as part of a Plan as a result of some but not all of those assets being transferred to Controlled without the recognition of all of the built-in gain on the transferred assets

before the distribution. No specific transactional form is required with regard to the transfer(s) of assets to Controlled, although such transfers must be made as part of a Plan. Thus, Distributing may recognize section 355(e) gain on a distribution of Controlled stock if Controlled acquired assets of any corporation identified as a POD, and the POD experiences a Planned 50-percent Acquisition of its stock.

b. Definition of a POD in the temporary regulations

Consistent with the synthetic spin-off analysis described in part 3.A.ii.a. of this preamble, the temporary regulations focus in a more conceptual manner on the division of property of any corporation other than Distributing or Controlled (a Potential Predecessor) as part of a Plan. Certain property of a Potential Predecessor (Relevant Property) is required to be tracked for the purpose of determining whether a division of the Potential Predecessor's property has occurred. Relevant Property is defined as any property held, directly or indirectly, by the Potential Predecessor at any point during the Plan Period. The Plan Period, in turn, is defined as the period that ends immediately after the distribution and begins on the earliest date on which any pre-distribution step that is part of the Plan is agreed to or understood, arranged, or substantially negotiated by one or more officers or directors acting on behalf of Distributing or Controlled, by controlling shareholders of Distributing or Controlled, or by another person or persons with the implicit or explicit permission of one or more of such officers, directors, or controlling shareholders. The temporary regulations generally do not treat as Relevant Property any property of a Potential Predecessor that was held directly or indirectly by Distributing or Controlled before a Plan existed. Rather, the definition of Relevant Property of a Potential Predecessor excludes any property held directly or indirectly by

Distributing unless that property was directly or indirectly transferred to Distributing as part of a Plan, and it was Relevant Property of the Potential Predecessor before the transfer.

Because POD status under the temporary regulations depends in large part upon the division of the Relevant Property of a Potential Predecessor, Relevant Property must be carefully defined and transfers of Relevant Property as part of a Plan must be tracked to achieve the goals of the temporary regulations. Thus, although the modified definition of a POD is conceptual in nature, it is implemented through application of a set of defined terms. In addition to Relevant Property and Plan Period, the following defined terms are integral to applying the modified definition of a POD:

Relevant Stock – Stock that is a Potential Predecessor's Relevant Property.

Substitute Asset – In general, any property that is held directly or indirectly by Distributing during the Plan Period and that was received in exchange for Relevant Property that was acquired directly or indirectly by Distributing if all gain on the transferred Relevant Property is not recognized in the exchange. In addition, stock received by Distributing in a distribution qualifying under section 305(a) or section 355(a) on Relevant Stock is a Substitute Asset.

Separated Property – Each item of Relevant Property that is transferred to Controlled as part of a Plan and is held by Controlled immediately before the distribution. Also, Controlled stock that is Relevant Property and that is transferred to, and distributed by, Distributing as part of a Plan.

Underlying Property – Property directly or indirectly held by a corporation that is the issuer of Relevant Stock.

The definition of a POD, which focuses on the division of Relevant Property as part of a Plan, requires the satisfaction of both pre-distribution and post-distribution requirements. There are two pre-distribution requirements: a Relevant Property requirement and a reflection of basis requirement. The Relevant Property requirement may be satisfied in two ways. The Relevant Property requirement may be satisfied if, before the distribution and as part of a Plan, Distributing directly or indirectly acquires Controlled stock in exchange for a direct or indirect interest in Relevant Property. In addition, Controlled must directly or indirectly hold Relevant Property immediately before the distribution, and the gain in the Relevant Property must not have been fully recognized as part of the Plan. The Relevant Property requirement also may be satisfied if any Controlled stock that is distributed as part of the Plan is Relevant Property, and the full amount of gain on that Controlled stock is not recognized as part of the Plan. In either case and as discussed earlier in this part 3.A.ii.b., for purposes of determining POD status, a Potential Predecessor will not be treated as an indirect owner of property that is directly or indirectly held by Distributing unless that property was transferred to Distributing as part of a Plan.

The reflection of basis requirement is satisfied only if any Controlled stock distributed in the distribution reflects the basis of any Separated Property. This requirement ensures that there is a connection between the gain in the property of a POD and the gain that would be included under an application of section 355(e) and these temporary regulations. For example, under this rule, if section 355(e) applies to each of two sequential distributions of Controlled stock, the Controlled stock that is distributed in the second distribution might not reflect any gain in Separated Property of

a Potential Predecessor of the first Distributing. In that case, the Potential Predecessor will not be treated as a POD for purposes of the second distribution, even though that Potential Predecessor may have been a POD for purposes of the first distribution.

In addition to the two pre-distribution requirements, a single post-distribution requirement applies: immediately after the distribution, direct or indirect ownership of Relevant Property must have been divided between Controlled on the one hand, and Distributing or the Potential Predecessor (or a successor of a Potential Predecessor) on the other hand. For purposes of the preceding sentence, if a Potential Predecessor transfers property in a section 381 transaction to a corporation (other than Distributing or Controlled) during the Plan Period, the corporation is a successor to the Potential Predecessor. If all of the Relevant Property of a Potential Predecessor is transferred to Controlled before the distribution, that Potential Predecessor is not a POD because its assets have not been divided.

Special rules apply to ensure that the occurrence of a reorganization under section 368(a)(1)(E) or (F) to which Distributing is a party does not affect the analysis of whether Distributing stock or Distributing's direct and indirect assets are treated as Relevant Property.

The definition of a POD under the temporary regulations captures many of the same transactions that would have been captured under the proposed regulations without modification. For example, the merger of a Potential Predecessor into Distributing as part of a Plan, followed by the transfer of some (but not all) of the assets of the Potential Predecessor to Controlled as part of the Plan would result in the Potential Predecessor being treated as a POD under both regulations. However, the

definition of a POD under the temporary regulations will reach a number of other Potential Predecessors, including indirect transferors, particularly because, under the modified definition, Relevant Property expressly includes both the directly and indirectly-held property of a Potential Predecessor. Therefore, in determining whether Relevant Property has been divided (and, thus, whether a POD exists), the temporary regulations consider an expanded pool of Potential Predecessors. For example, if a Potential Predecessor transfers Relevant Property to Distributing in a section 351 exchange as part of a Plan, the Potential Predecessor may be a POD, as may be a direct or indirect corporate shareholder of the Potential Predecessor (an indirect owner of the Relevant Property during the Plan Period), if the Potential Predecessor's Relevant Property (directly or indirectly held) is ultimately divided, as part of the Plan, as a result of the distribution. As another example, a Potential Predecessor that merges into Distributing in a forward triangular merger as part of a Plan may be a POD, as well as a direct or indirect corporate shareholder of the Potential Predecessor during the Plan Period. However, as discussed earlier in this part 3.A.ii.b., in either case, the Potential Predecessor's Relevant Property ultimately must be divided as part of the Plan to satisfy the post-distribution requirement.

As discussed earlier in this part 3.A.ii.b., the temporary regulations require the tracking of assets for purposes of identifying PODs; as discussed further in part 3.B. of this preamble, the temporary regulations also require asset tracking for purposes of application of the gain limitation rules. However, to alleviate this burden (as identified in the comments received on the proposed regulations), the temporary regulations provide that only direct or indirect transfers of Relevant Property (including Controlled stock) by

a Potential Predecessor to Distributing (or to a POD (see discussion in part 3.A.iii. of this preamble)) that occur as part of a Plan are relevant in determining whether a Potential Predecessor is treated as a POD or a predecessor of a POD (the Plan Limitation). Similarly, only assets transferred as part of a Plan are relevant for application of the gain limitation rules. If no transfer of property of a Potential Predecessor to Distributing or Controlled occurs as part of a Plan, there is no requirement for taxpayers to track assets of any Potential Predecessor under the temporary regulations.

The Treasury Department and the IRS recognize that there may be potential difficulties in applying section 355(e) to a POD that does not cease to exist as a result of the transaction in which it becomes a POD. However, it is expected that in many (if not most) cases, a POD will cease to exist as a result of the transaction in which it becomes a POD. Further, under the first gain limitation rule of the temporary regulations, Distributing will recognize section 355(e) gain on the division of Relevant Property only if there has been a Planned 50-percent Acquisition of a POD. Because only acquisitions of a POD's stock that occur as part of a Plan are relevant to these inquiries, Distributing should be in possession of the necessary information to determine whether section 355(e) will apply. The Treasury Department and the IRS request comments regarding the integration of the Plan Limitation rule and the definition of a POD under the temporary regulations.

iii. Substitute Assets and POCs

As discussed in part 3.A.ii.b. of this preamble, the POD status under these temporary regulations depends in large part upon the division of Relevant Property of a

Potential Predecessor as part of a Plan. Therefore, to better effectuate the tracking of Relevant Property (and, by extension, Separated Property), these temporary regulations broaden the definition of a Substitute Asset, which is treated as Relevant Property.

Under these temporary regulations, a Substitute Asset is any property that is held directly or indirectly by Distributing during the Plan Period and was received in exchange for Relevant Property that was acquired directly or indirectly by Distributing if all gain on the transferred Relevant Property is not recognized on the exchange.

Controlled stock may constitute a Substitute Asset (and thus, Relevant Property) only if that Controlled stock received (or deemed received) in the exchange reflects the basis of Relevant Stock and the issuer of that Relevant Stock ceases to exist for Federal income tax purposes under the Plan. Treatment of this type of Controlled stock as Relevant Property eliminates the need for application of the POC concept for purposes of determining POD status and computing gain limitations. Accordingly, these temporary regulations reduce the scope of the POC rule to apply solely for purposes of applying the affiliated group rule of section 355(e)(2)(C).

iv. Successive Predecessors

The Treasury Department and the IRS have determined that the Plan Limitation rule described in part 3.A.ii.b. of this preamble mitigates much of the burden associated with tracking successive PODs. Thus, the temporary regulations treat a predecessor of a POD as a POD. A corporation is a predecessor of a POD if it transfers assets to the POD as part of a Plan, and all additional pre- and post-distribution requirements are satisfied with respect to its assets. The temporary regulations include a similar rule with respect to a predecessor of a POC. Because the temporary regulations recognize

successive predecessors of Distributing and Controlled, it is no longer necessary to include the general operating rule contained in the proposed regulations that would have treated the resulting corporation in an F reorganization as the same corporation that engaged in the reorganization. Accordingly, the temporary regulations eliminate this operating rule.

B. Special rules for gain recognition

The gain limitation rules of the proposed regulations are incorporated in the temporary regulations, with modifications to address certain concerns of commenters. Commenters expressed three main concerns with respect to the first gain limitation in the proposed regulations, which applies if there is a Planned 50-percent Acquisition of a POD.

First, commenters stated that the hypothetical section 351 exchange construct used in the first gain limitation rule to determine Distributing's section 355(e) gain on a Planned 50-percent Acquisition of a POD was unnecessarily complicated because of its reliance on rules ancillary to section 351. Specifically, commenters were uncertain as to whether (or how) the loss importation rules under then-recently-enacted section 362(e) would apply to the hypothetical section 351 exchange. Commenters requested that, in lieu of the hypothetical section 351 exchange, gain be limited to the difference between the aggregate basis in the POD's assets actually transferred to Controlled and the aggregate fair market value of those assets immediately before the distribution.

The second main concern of commenters was that the proposed regulations imposed a tracking burden with respect to a POD's assets. Third, commenters noted that measuring the value of Controlled stock acquired by Distributing from a POD at the

time of the combining transfer (as opposed to at the time of the distribution, as is the case with other property) could be burdensome.

With regard to the first concern, the Treasury Department and the IRS do not agree with the commenters' suggestion that the first gain limitation rule applicable to a Planned 50-percent Acquisition of a POD should be measured solely by reference to the difference between the aggregate basis and the aggregate fair market value in a POD's assets transferred to Controlled. Outside of the POD context, application of section 355(e) results in the recognition of gain on Controlled stock, rather than on assets held by Controlled. As discussed in part 3.A.ii.a. of this preamble, the policy underlying the proposed regulations was to apply section 355(e) to result in section 355(e) gain equivalent to that obtained if some of the assets of a POD had been transferred to a hypothetical Controlled without full recognition of gain, and a division of the POD's assets were accomplished through a hypothetical distribution to which section 355(e) applied. That theory continues to underlie these temporary regulations. Therefore, the Treasury Department and the IRS have determined that a limitation on section 355(e) gain equal to the gain in the stock of a hypothetical Controlled following a transfer of POD assets is appropriate. In addition, the commenters' concerns regarding the possible application of section 362(e), highlighted by the use of a hypothetical section 351 and sale construct in the proposed regulations, should be eased by the intervening promulgation of final regulations under section 362(e)(1) and (2). See §§1.362-3 and 1.362-4. However, to avoid confusion regarding the applicable Code provisions to be applied in determining the appropriate amount of section 355(e) gain to be recognized by Distributing, these temporary regulations modify the first and second

gain limitation rules to result in section 355(e) gain that would have been present in hypothetical Controlled stock, had Distributing transferred assets to a hypothetical Controlled and distributed its stock in a hypothetical reorganization under section 368(a)(1)(D) and section 355(e) (a Hypothetical D/355(e) Reorganization), rather than a section 351 exchange followed by a hypothetical sale. This formulation will more closely reflect the policy underlying the proposed regulations and these temporary regulations.

With regard to the second concern, as discussed in part 3.A.ii.b. of this preamble, these temporary regulations mitigate the burden of tracking assets by providing that a Potential Predecessor can be a POD only if the assets of the Potential Predecessor are transferred as part of a Plan. If such a transfer occurs as part of a Plan, the required tracking burden is knowable by Distributing; if there is no Plan, there is no requirement to track any assets of a Potential Predecessor under the temporary regulations. In addition, the Treasury Department and the IRS continue to view the burden of tracking a POD's assets imposed by the first gain limitation rule as preferable to requiring Distributing to recognize the full amount of section 355(e) gain that Distributing would otherwise recognize under section 355(c)(2) or 361(c)(2) (the Statutory Recognition Amount) in the absence of such a rule. Nevertheless, the temporary regulations provide that Distributing may choose not to apply the first or second gain limitation rules to a distribution, and instead may recognize the Statutory Recognition Amount, by reporting the Statutory Recognition Amount on its original or amended Federal income tax return for the year of the distribution.

With regard to the measurement of gain on Controlled stock that is Separated Property, the Treasury Department and the IRS agree that it is preferable to measure this gain as of the time of the distribution. Using the date of the distribution to measure the gain attributable to the POD's Controlled stock allows for investment adjustments to be made with respect to such stock if Distributing is a member of a consolidated group. Such adjustments often will mitigate the effect of multiple layers of taxation on the same economic gain. Accordingly, these temporary regulations include modifications to the proposed regulations that address the commenters' concerns.

The temporary regulations implement the modifications discussed using terminology that is consistent with the modification of the definition of a POD. Thus, the temporary regulations provide that the first gain limitation rule applicable to a Planned 50-percent Acquisition of a POD equals the amount of section 355(e) gain Distributing would have recognized if, immediately before the distribution, Distributing had transferred all the Separated Property received from the POD to a newly-formed corporation in exchange solely for stock of such corporation in a Hypothetical D/355(e) Reorganization.

With regard to situations in which there is a Planned 50-percent Acquisition of Distributing, the temporary regulations modify the language of the second gain limitation rule to conform to the modified definition of a POD. However, the substance of the rule remains: if the Planned 50-percent Acquisition of Distributing stock occurs in a section 381 transaction in which a POD transfers its assets to Distributing, the amount of section 355(e) gain recognized is limited. This rule is intended to minimize the Federal income tax impact of directionality between economically equivalent section 381

transactions. That is, the same result should obtain under the temporary regulations regardless of which party to the section 381 transaction is the transferor corporation and which is the acquiring corporation.

Because the temporary regulations require the tracking of both the direct and indirect assets of PODs, the Treasury Department and the IRS have determined that certain additional limitations on the recognition of gain are appropriate. First, the definition of Separated Property excludes property indirectly held by a POD if the stock of the corporation that directly owns the property is Separated Property (and thus is already taken into account for gain recognition purposes). Thus, a corporation's Underlying Property is excluded from the gain recognition computation if the corporation's stock is Relevant Stock transferred to Controlled as part of a Plan and held by Controlled immediately before the distribution. The temporary regulations also provide a prohibition on counting the same asset as Relevant Property of successive PODs, as well as a more general anti-duplication rule, which ensures that the same economic gain is not captured multiple times under section 355(e) and these regulations.

C. Section 336(e) election

Effective for certain sales, exchanges, or distributions of stock made by a domestic corporation on or after May 15, 2013, regulations under section 336(e) permit, in certain circumstances, a domestic corporation to elect to treat a sale, exchange, or distribution of the stock of a corporation as an asset sale. See §§1.336-1 through 1.336-5. The temporary regulations clarify that Distributing may elect to apply the regulations under section 336(e) to a distribution of Controlled stock to which the

temporary regulations apply, provided that the transaction otherwise satisfies the requirements of the regulations under section 336(e), and Distributing would otherwise be required under these temporary regulations to recognize the Statutory Recognition Amount with respect to the Controlled stock it distributes.

D. Successors

In the preamble to the proposed regulations, the Treasury Department and the IRS requested comments regarding whether transferees of the property of Distributing or Controlled in transactions other than section 381 transactions should be considered Successors. One comment on the proposed regulations endorsed treating a transferee in a section 351 or section 721 transaction as a Successor, but only in limited circumstances. Although the Treasury Department and the IRS continue to study this issue, the temporary regulations treat as a Successor for section 355(e) purposes only a transferee to which Distributing or Controlled transferred its assets in a section 381 transaction after a distribution.

E. Section 355(f)

As described in part 1.B. of this preamble, by operation of section 355(e)(2)(C), section 355(e) does not apply to an Internal Distribution if immediately after the Plan Distributing and each Controlled remain members of the same Expanded Affiliated Group. Also, as described in part 1.B. of this preamble, section 355(f) prevents section 355 from applying to an Internal Distribution if section 355(e) would otherwise apply to such distribution (that is, if after the Plan, Controlled or the Lower-Tier Distributing is not a member of the affiliated group as a result of an External Distribution). Because section 355 would not apply, the Internal Distribution would be taxable, and the

shareholder or security holder would take the Controlled stock or securities with a fair market value basis under section 301(d). Upon the subsequent External Distribution, there typically no longer would be built-in gain in the Controlled stock or securities to result in additional section 355(e) gain.

The Treasury Department and the IRS have determined that the application of section 355(f) may frustrate the policy underlying the first and second gain limitation rules of these temporary regulations in certain cases. Specifically, if there is a Planned 50-percent Acquisition of only a predecessor of the Lower-Tier Distributing (and not of Controlled or the Lower-Tier Distributing), the stock or securities of Controlled are distributed in an Internal Distribution by the Lower-Tier Distributing, and each of the acquisition(s) and the Internal Distribution precedes an External Distribution of Controlled as part of the same Plan, then section 355(f) would be expected to apply to the Internal Distribution. If section 355(f) were to apply, no part of section 355 would apply (including the gain limitation rules under these temporary regulations). Without application of the first and second gain limitation rules, the full amount of built-in gain in the Controlled stock or securities would be recognized by the Lower-Tier Distributing under section 311 on its distribution of Controlled stock, even though section 355(f) would have applied only as a result of a Planned 50-percent Acquisition of a predecessor of the Lower-Tier Distributing (and not of Controlled or the Lower-Tier Distributing). However, there may be circumstances under which taxpayers wish to apply section 355(f) to such distributions instead of the first or second gain limitation rules provided by these temporary regulations.

Accordingly, these temporary regulations provide that section 355(f) does not apply if there is a Planned 50-percent Acquisition of the stock of a predecessor of a Lower-Tier Distributing but not of the stock of the Lower-Tier Distributing or Controlled. As a result, section 355(e), including the first and second gain limitation rules in these temporary regulations, applies to the Internal Distribution. However, the temporary regulations provide that a Lower-Tier Distributing may choose to apply section 355(f) to an Internal Distribution it makes without any limitation on the gain it recognizes, but only if each member of the affiliated group (as defined in section 1504(a)) of which the Lower-Tier Distributing is a member reports the Federal income tax consequences of the Internal Distribution consistent with the application of section 355(f).

Effective/ Applicability Date

These temporary regulations apply to distributions that occur after **[INSERT DATE 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**. However, these regulations do not apply to a distribution that is: (1) made pursuant to a binding agreement in effect on or before **[INSERT DATE OF FILING FOR PUBLIC INSPECTION BY THE FEDERAL REGISTER]**, and at all times thereafter, (2) described in a ruling request submitted to the IRS on or before **[INSERT DATE OF FILING FOR PUBLIC INSPECTION BY IN THE FEDERAL REGISTER]** for a transaction that is not modified after such date, or (3) described on or before **[INSERT DATE OF FILING FOR PUBLIC INSPECTION BY THE FEDERAL REGISTER]** in a public announcement or in a filing with the Securities and Exchange Commission. In addition, Distributing and any affiliated group of which it is a member may consistently apply these regulations in their entirety to any distribution occurring after November 22, 2004. If so, taxpayers must

consistently apply this section in its entirety to all distributions occurring after November 22, 2004, that are part of the same Plan.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. These temporary regulations are necessary to provide necessary guidance regarding the identity of predecessor and successor corporations of distributing and controlled corporations, to enable taxpayers to utilize the benefit of certain gain limitation rules with respect to certain section 355(e) transactions, and to enable taxpayers to choose to apply or not to apply section 355(f). These subjects were framed for discussion in a prior notice of proposed rulemaking (REG-145535-02) and modifications to the proposed regulations in these temporary regulations either flow directly from comments received relating to the definition of a Predecessor of Distributing set forth in that notice of proposed rulemaking or permit taxpayers to effectively elect the tax consequences of transactions subject to the proposed regulations. For this reason, it has been determined, pursuant to 5 U.S.C. 553(b)(B), that good cause exists for dispensing with the notice and public comment procedures. However, to minimize their effect on pending transactions, these regulations apply only to distributions occurring 30 days or more after the date this Treasury decision is published in the **Federal Register**. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble of the cross-referenced notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register**. Pursuant to section

7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Lynlee C. Baker, formerly of the Office of Associate Chief Counsel (Corporate). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.355-8T also issued under 26 U.S.C. 336(e) and 355(e)(5).

Par. 2. Section 1.355-0 is amended by revising the introductory text and adding an entry for §1.355-8T to read as follows:

§1.355-0 Outline of sections.

In order to facilitate the use of §§1.355-1 through 1.355-8T, this section lists the major paragraphs in those sections as follows:

* * * * *

§1.355-8T Definition of predecessor and successor and limitations on gain recognition under section 355(e) and section 355(f).

- (a) In general.
 - (1) Scope.
 - (2) Purpose.
 - (3) Overview.
 - (4) References.
 - (i) References to Distributing or Controlled.
 - (ii) References to Plan or distribution
 - (iii) Plan Period.
- (b) Predecessor of Distributing.
 - (1) Definition.
 - (i) In general.
 - (ii) Pre-distribution requirements.
 - (A) Relevant Property.
 - (B) Reflection of basis.
 - (iii) Post-distribution requirement.
 - (2) Additional definitions and rules related to paragraph (b)(1) of this section.
 - (i) References to Distributing and Controlled.
 - (ii) Potential Predecessor.
 - (iii) Successors of Potential Predecessors.
 - (iv) Relevant Property; Relevant Stock.
 - (A) In general.
 - (B) Property held by Distributing.
 - (C) Certain reorganizations.
 - (v) Stock of Distributing as Relevant Property.
 - (A) In general.
 - (B) Certain reorganizations.
 - (vi) Substitute Asset.
 - (vii) Separated Property.
 - (viii) Underlying Property.
 - (ix) Scope of definition of Predecessor of Distributing.
 - (x) Deemed exchanges.
 - (c) Additional definitions.
 - (1) Predecessor of Controlled.
 - (2) Successors.
 - (i) In general.
 - (ii) Determination of Successor status.
 - (3) Section 381 transaction.
 - (d) Special acquisition rules.
 - (1) Deemed acquisitions of stock in section 381 transactions.
 - (2) Deemed acquisitions of stock after section 381 transactions.
 - (3) Separate counting for Distributing and each Predecessor of Distributing.
- (e) Special rules for gain recognition.
 - (1) In general.
 - (2) Planned 50-percent or greater acquisitions of a Predecessor of Distributing.
 - (i) In general.

- (ii) Operating rules.
- (A) Separated Property other than Controlled stock.
- (B) Controlled stock that is Separated Property.
- (C) Anti-duplication rule.
- (3) Planned 50-percent Acquisition of Distributing in a section 381 transaction.
- (4) Overall gain recognition.
- (5) Section 336(e) election.
- (f) Predecessor or Successor as a member of the affiliated group.
- (g) Inapplicability of section 355(f) to certain intra-group distributions.
- (1) In general.
- (2) Alternative application of section 355(f).
- (h) Examples.
- (i) Effective/applicability date.
- (1) In general.
- (2) Transition rule.
- (i) In general.
- (ii) Definition of distribution.
- (3) Exception.

Par. 3. Section 1.355-8T is added to read as follows:

§1.355-8T Definition of predecessor and successor and limitations on gain recognition under section 355(e) and section 355(f) (temporary).

(a) In general--(1) Scope. This section provides rules under section 355(e)(4)(D) to determine whether a corporation is treated as a predecessor or successor of a distributing corporation (Distributing) or a controlled corporation (Controlled) for purposes of section 355(e). This section also provides rules limiting the amount of Distributing's gain recognized under section 355(e) on the distribution of Controlled stock if section 355(e) applies to an acquisition by one or more persons, as part of a Plan (within the meaning of §1.355-7 as modified by paragraph (a)(3) of this section), of stock that in the aggregate represents a 50-percent or greater interest (a Planned 50-percent Acquisition) of a Predecessor of Distributing (as defined in paragraph (b) of this section), or of Distributing. In addition, this section provides rules regarding the application of section 336(e) to a distribution to which this section applies and the

application of section 355(f) to a distribution of Controlled stock in certain cases.

(2) Purpose. The rules in this section have two principal purposes. The first is to ensure that section 355(e) applies to a section 355 distribution if, as part of a Plan, some of the assets of a Predecessor of Distributing (as defined in paragraph (b)(1) of this section) are transferred directly or indirectly to Controlled without full recognition of gain, and the distribution accomplishes a division of the assets of the Predecessor of Distributing. The second is to ensure that section 355(e) applies when there is a Planned 50-percent Acquisition of a Successor of Distributing or Successor of Controlled (as defined in paragraph (c)(2) of this section). The rules of this section must be interpreted and applied in a manner that is consistent with and reasonably carries out the purposes of this section.

(3) Overview. This section applies if a distribution of Controlled stock (or stock and securities) is part of the same Plan that includes a Planned 50-percent Acquisition of a Predecessor of Distributing, Distributing, Controlled, a Successor of Distributing, or a Successor of Controlled. Paragraph (a)(4) of this section provides rules regarding references to the terms Distributing, Controlled, distribution, Plan, and Plan Period for purposes of section 355(e), §1.355-7, and this section. Paragraph (b) of this section defines the term Predecessor of Distributing and several related terms. A corporation generally will be a Predecessor of Distributing if: as part of a Plan, the distribution accomplishes a division of the assets that the corporation directly and indirectly held during the Plan Period; that division occurs through transfers, as part of a Plan, resulting in Controlled directly or indirectly holding some but not all of those assets immediately after the distribution; and all of the gain on that corporation's assets directly or indirectly

held by Controlled is not recognized before the distribution. In addition, a corporation generally will be a Predecessor of Distributing if: as part of a Plan, the distribution accomplishes a division of the assets that it directly and indirectly held during the Plan Period; that division occurs as a result of the direct or indirect transfer of Controlled stock by that corporation to Distributing without the transfer of all of the corporation's other assets to Controlled; and all of the gain on the corporation's assets (including the Controlled stock) directly or indirectly held by Controlled is not recognized before the distribution. In both cases, Controlled stock distributed in the distribution must reflect the basis of any Separated Property (as defined in paragraph (b)(2)(vii) of this section). Paragraph (c) of this section defines other terms, including Predecessor of Controlled and Successor (of Distributing or Controlled). Paragraph (d) of this section provides guidance with regard to acquisitions and deemed acquisitions of stock if there is a Predecessor of Distributing or a Successor of either Distributing or Controlled. Paragraph (e) of this section provides two rules that may limit the amount of Distributing's gain on the distribution of Controlled stock if there is a Predecessor of Distributing, as well as an overall gain limitation. Paragraph (e) of this section also provides guidance with respect to the application of section 336(e). Regardless of whether there is a predecessor or successor of Distributing or Controlled, paragraph (f) of this section provides a special rule relating to section 355(e)(2)(C), which provides that section 355(e) does not apply to certain transactions within an affiliated group (as defined in section 1504(a) without regard to section 1504(b)). Paragraph (g) of this section provides rules coordinating the application of section 355(f) with the rules of this section. Paragraph (h) of this section contains examples that illustrate the rules of this

section.

(4) References--(i) References to Distributing or Controlled. For purposes of section 355(e) and the regulations thereunder, except as otherwise provided in this section, any reference to Distributing or Controlled includes, as the context may require, a reference to any Predecessor of Distributing (as defined in paragraph (b)(1) of this section) or Predecessor of Controlled (as defined in paragraph (c)(1) of this section), respectively, or any Successor (as defined in paragraph (c)(2) of this section) of Distributing or Controlled, respectively. However, except as otherwise provided in this section, a reference to a Predecessor of Distributing or to a Successor of Distributing does not include a reference to Distributing, and a reference to a Predecessor of Controlled or to a Successor of Controlled does not include a reference to Controlled.

(ii) References to Plan or distribution. Except as otherwise provided in this section, references to a Plan in this section are references to a plan within the meaning of §1.355-7. References to a distribution in §1.355-7 include a reference to a distribution and other related pre-distribution transactions that together effect a division of the assets of a Predecessor of Distributing. In determining whether a distribution and a Planned 50-percent Acquisition of a predecessor or successor of Distributing or Controlled are part of a Plan, the rules of §1.355-7 apply. In those cases, references to Distributing or Controlled in §1.355-7 generally include references to a predecessor or successor of Distributing or Controlled. However, with regard to any possible Planned 50-percent Acquisition of a Predecessor of Distributing, any agreement, understanding, arrangement, or substantial negotiations with regard to the acquisition of the stock of the Predecessor of Distributing is analyzed under §1.355-7 with regard to the actions of

officers or directors of Distributing or Controlled, controlling shareholders (as defined in §1.355-7(h)(3)) of Distributing or Controlled, or a person acting with permission of one of those parties. For that purpose, references in §1.355-7 to Distributing do not include references to a Predecessor of Distributing. Therefore, the actions of officers or directors, or controlling shareholders of a Predecessor of Distributing, or a person acting with the implicit or explicit permission of one of those parties are not considered unless those parties otherwise would be treated as acting on behalf of Distributing or Controlled under §1.355-7 (for example, if a Predecessor of Distributing is a controlling shareholder of Distributing).

(iii) Plan Period. For purposes of this section, the term Plan Period means the period that ends immediately after the distribution and begins on the earliest date on which any pre-distribution step that is part of the Plan is agreed to or understood, arranged, or substantially negotiated by one or more officers or directors acting on behalf of Distributing or Controlled, by controlling shareholders of Distributing or Controlled, or by another person or persons with the implicit or explicit permission of one or more of such officers, directors, or controlling shareholders. For purposes of the preceding sentence, references to Distributing and Controlled do not include references to any predecessor or successor of Distributing or Controlled.

(b) Predecessor of Distributing--(1) Definition--(i) In general. A Potential Predecessor (as defined in paragraph (b)(2)(ii) of this section) is a Predecessor of Distributing if, taking into account the special rules of paragraph (b)(2) of this section, the pre-distribution requirements of paragraph (b)(1)(ii) of this section and the post-distribution requirements of paragraph (b)(1)(iii) of this section are satisfied.

(ii) Pre-distribution requirements--(A) Relevant Property. Before the distribution, and as part of a Plan, either--

(1) Any Controlled stock distributed in the distribution was directly or indirectly acquired (or deemed acquired under paragraph (b)(2)(x) of this section) by Distributing in exchange for any direct or indirect interest in Relevant Property (as defined in paragraph (b)(2)(iv) of this section)--

(i) That is held directly or indirectly by Controlled immediately before the distribution; and

(ii) The gain on which was not recognized in full as part of a Plan; or

(2) Any Controlled stock that is distributed in the distribution is Relevant Property of the Potential Predecessor, and the gain on that Controlled stock was not recognized in full as part of a Plan.

(B) Reflection of basis. Any Controlled stock distributed in the distribution reflects the basis of any Separated Property (as defined in paragraph (b)(2)(vii) of this section).

(iii) Post-distribution requirement. Immediately after the distribution, direct or indirect ownership of Relevant Property has been divided between Controlled on the one hand, and Distributing or the Potential Predecessor (or a successor of a Potential Predecessor) on the other hand. For purposes of this paragraph (b)(1)(iii), if Controlled stock that is distributed in the distribution is Relevant Property of a Potential Predecessor, then Controlled is deemed to have received Relevant Property of the Potential Predecessor.

(2) Additional definitions and rules related to paragraph (b)(1) of this section--(i)

References to Distributing and Controlled. For purposes of paragraphs (b)(1)(ii) and (b)(1)(iii) of this section, references to Distributing and Controlled do not include references to any predecessor or successor of Distributing or Controlled.

(ii) Potential Predecessor. The term Potential Predecessor means a corporation other than Distributing or Controlled.

(iii) Successors of Potential Predecessors. For purposes of paragraph (b)(1)(iii) of this section, if a Potential Predecessor transfers property in a section 381 transaction to a corporation (other than Distributing or Controlled) during the Plan Period, the corporation is a successor to the Potential Predecessor.

(iv) Relevant Property; Relevant Stock--(A) In general. Except as otherwise provided in this paragraph (b)(2)(iv), the term Relevant Property means any property that was held, directly or indirectly, by the Potential Predecessor during the Plan Period. The term Relevant Stock means stock of a corporation if that stock is a Potential Predecessor's Relevant Property.

(B) Property held by Distributing. Except as provided in paragraph (b)(2)(iv)(C) of this section, property held directly or indirectly by Distributing (including Controlled stock) is Relevant Property of a Potential Predecessor only to the extent that the property was transferred directly or indirectly to Distributing during the Plan Period, and it was Relevant Property of the Potential Predecessor before the direct or indirect transfers. For example, if during the Plan Period a subsidiary corporation of a Potential Predecessor merges into Controlled in a reorganization under section 368(a)(1)(A) and (2)(D), and, as a result, the Potential Predecessor directly or indirectly owns Distributing stock received in the merger, the subsidiary's assets held by Controlled will be Relevant

Property of that Potential Predecessor.

(C) Certain reorganizations. For purposes of paragraph (b)(2)(iv)(B) of this section, the transferor and transferee in any reorganization described in section 368(a)(1)(F) (F reorganization) are treated as a single corporation. Therefore, for example, Relevant Property acquired during the Plan Period by a corporation that is a transferor (as to a later F reorganization) is treated as having been acquired directly (and from the same source) by the transferee (as to the later F reorganization) during the Plan Period. In addition, any transfer (or deemed transfer) of assets to Distributing in an F reorganization will not cause the transferred assets to be treated as Relevant Property.

(v) Stock of Distributing as Relevant Property--(A) In general. For purposes of paragraph (b)(1)(ii) of this section, except as provided in paragraph (b)(2)(v)(B) of this section, stock of Distributing is not Relevant Stock (and thus not Relevant Property) to the extent that the Potential Predecessor becomes, as part of a Plan, the direct or indirect owner of that stock as the result of the transfer to Distributing of direct or indirect interests in the Potential Predecessor's Relevant Property. For example, stock of Distributing is not Relevant Stock if it is acquired by a Potential Predecessor as part of a Plan in an exchange to which section 351(a) applies.

(B) Certain reorganizations. For purposes of paragraph (b)(1)(ii) of this section, stock of Distributing is Relevant Stock (and thus Relevant Property) to the extent that the Potential Predecessor becomes, as part of the Plan, the direct or indirect owner of that stock as the result of a transaction described in section 368(a)(1)(E).

(vi) Substitute Asset. The term Substitute Asset means any property that is held

directly or indirectly by Distributing during the Plan Period and was received, during the Plan Period, in exchange for Relevant Property that was acquired directly or indirectly by Distributing if all gain on the transferred Relevant Property is not recognized on the exchange. For example, property received by Controlled in exchange for Relevant Property in a transaction qualifying under section 1031 is a Substitute Asset.

Irrespective of the general rule of this paragraph (b)(2)(vi), stock of Controlled received in exchange for a direct or indirect transfer of Relevant Property by Distributing generally is not a Substitute Asset. However, if Controlled stock received or deemed received in an exchange reflects in whole or in part the basis of Relevant Stock the issuer of which ceases to exist for Federal income tax purposes under the Plan, then that Controlled stock will constitute a Substitute Asset. See paragraph (b)(2)(x) of this section. In addition, stock received by Distributing in a distribution qualifying under section 305(a) or section 355(a) on Relevant Stock is a Substitute Asset. For purposes of this section, a Substitute Asset is treated as Relevant Property with the same ownership and transfer history as the Relevant Property for which (or on which) it was received.

(vii) Separated Property. The term Separated Property means each item of Relevant Property that is described in paragraph (b)(1)(ii)(A) of this section. However, if Relevant Stock is Separated Property, Underlying Property (as defined in paragraph (b)(2)(viii) of this section) associated with that stock is not treated as Separated Property. In addition, if Distributing directly or indirectly acquires Relevant Stock in a transaction in which gain is recognized in full, Underlying Property associated with that stock is not treated as Separated Property.

(viii) Underlying Property. The term Underlying Property means property directly or indirectly held by a corporation that is the issuer of Relevant Stock.

(ix) Scope of definition of Predecessor of Distributing. If there are multiple Potential Predecessors that satisfy the requirements of paragraph (b)(1) of this section, each of those Potential Predecessors will be a Predecessor of Distributing. For example, a Potential Predecessor that transfers property to a Predecessor of Distributing without full recognition of gain (and that otherwise meets the requirements of paragraph (b)(1) of this section) is also a Predecessor of Distributing if the applicable transfer occurred as part of a Plan that existed at the time of such transfer.

(x) Deemed exchanges. For purposes of paragraph (b)(1)(ii) and (b)(2)(vi) of this section, Distributing is treated as acquiring Controlled stock in exchange for a direct or indirect interest in Relevant Property if the basis of Distributing in that Controlled stock reflects the basis of the Relevant Property in whole or in part.

(c) Additional definitions--(1) Predecessor of Controlled. Solely for purposes of applying paragraph (f) of this section, a corporation is a Predecessor of Controlled if, before the distribution, it transfers property to Controlled in a section 381 transaction as part of a Plan. Other than for the purpose described in the preceding sentence, no corporation can be a Predecessor of Controlled. For purposes of this paragraph (c)(1), a reference to Controlled includes a reference to a Predecessor of Controlled. If multiple corporations satisfy the requirements of this paragraph (c)(1), each of those corporations will be a Predecessor of Controlled. For example, a corporation that transfers property to a Predecessor of Controlled in a section 381 transaction is also a Predecessor of Controlled if the section 381 transaction occurred as part of a Plan that

existed at the time of such transaction.

(2) Successors--(i) In general. A Successor of Distributing or Controlled, respectively, is a corporation to which Distributing or Controlled transfers property in a section 381 transaction after the distribution (a Successor Transaction).

(ii) Determination of Successor status. More than one corporation may be a Successor of Distributing or Controlled. Therefore, if Distributing transfers property to another corporation (X) in a section 381 transaction, and X transfers property to another corporation (Y) in a section 381 transaction, then each of X and Y may be a Successor of Distributing. In this case, the determination of whether Y is a Successor of Distributing is made after the determination of whether X is a Successor of Distributing.

(3) Section 381 transaction. The term section 381 transaction means a transaction to which section 381 applies.

(d) Special acquisition rules--(1) Deemed acquisitions of stock in section 381 transactions. Each person that owned an interest in the acquiring corporation immediately before a section 381 transaction (an Acquiring Owner) is treated for purposes of this section as acquiring, in the section 381 transaction, stock representing an interest in the distributor or transferor corporation, to the extent that the Acquiring Owner did not hold an equivalent direct or indirect interest in the distributor or transferor corporation before the section 381 transaction. For example, if Distributing held a 25-percent interest in a Predecessor of Distributing before a section 381 transaction in which the Predecessor of Distributing transfers its assets to Distributing, each person that owns an interest in Distributing is treated as acquiring in the section 381 transaction a proportionate share of the remaining 75-percent interest in the Predecessor of

Distributing. Similarly, each Acquiring Owner of a Successor of Distributing is treated as acquiring, in the Successor Transaction, stock of Distributing, to the extent that the Acquiring Owner did not hold an equivalent direct or indirect interest in Distributing before the section 381 transaction.

(2) Deemed acquisitions of stock after section 381 transactions. For purposes of this section, after a section 381 transaction (including a Successor Transaction), an acquisition of stock of an acquiring corporation (including a deemed stock acquisition under paragraph (d)(1) of this section) is treated also as an acquisition of an interest in the stock of the distributor or transferor corporation. For example, an acquisition of the stock of Distributing that occurs after a section 381 transaction is treated not only as an acquisition of the stock of Distributing, but also as an acquisition of the stock of any Predecessor of Distributing whose assets were acquired by Distributing in a prior section 381 transaction. Similarly, an acquisition of the stock of a Successor of Distributing that occurs after the Successor Transaction is treated not only as an acquisition of the stock of the Successor of Distributing, but also as an acquisition of the stock of Distributing.

(3) Separate counting for Distributing and each Predecessor of Distributing. The measurement of whether one or more persons have acquired stock of any specific corporation in a Planned 50-percent Acquisition is made separately from the measurement of any potential Planned 50-percent Acquisition of any other corporation. Therefore, there may be a Planned 50-percent Acquisition of a Predecessor of Distributing even if there is no Planned 50-percent Acquisition of Distributing. Similarly, there may be a Planned 50-percent Acquisition of Distributing even if there is no

Planned 50-percent Acquisition of a Predecessor of Distributing.

(e) Special rules for gain recognition--(1) In general. If there are Planned 50-percent Acquisitions of multiple corporations (for example, two Predecessors of Distributing), Distributing must recognize gain in the amount described in section 355(c)(2) or 361(c)(2) (the Statutory Recognition Amount), as applicable, with respect to each such corporation, subject to the limitations in paragraph (e)(2) of this section (relating to the Planned 50-percent Acquisition of a Predecessor of Distributing) and paragraph (e)(3) of this section (relating to the Planned 50-percent Acquisition of Distributing), if applicable. The limitations in paragraphs (e)(2) and (e)(3) of this section are applied separately to the Planned 50-percent Acquisition of each such corporation to determine the amount of gain required to be recognized. Paragraph (e)(4) of this section sets forth an overall limitation based on the full amount of gain otherwise required to be recognized by Distributing by reason of section 355(e). Paragraph (e)(5) of this section clarifies the availability of an election under section 336(e) with regard to certain distributions.

(2) Planned 50-percent or greater acquisitions of a Predecessor of Distributing--(i) In general. If there is a Planned 50-percent Acquisition of a Predecessor of Distributing, the amount of gain recognized by Distributing by reason of section 355(e) as a result of the Planned 50-percent Acquisition is limited to the amount of gain, if any, that Distributing would have recognized if, immediately before the distribution, Distributing had engaged in the following transaction: Distributing transferred all Separated Property received from the Predecessor of Distributing to a newly-formed corporation in exchange solely for stock of such corporation in a reorganization under

section 368(a)(1)(D) and then distributed the stock of such corporation to the shareholders of Distributing in a transaction to which section 355(e) applied (a Hypothetical D/355(e) Reorganization). This computation is applied regardless of whether Distributing actually directly held the Separated Property.

(ii) Operating rules. For purposes of applying paragraph (e)(2)(i) of this section, the following rules apply:

(A) Separated Property other than Controlled stock. The basis and fair market value of Separated Property other than stock of Controlled treated as transferred by Distributing to a hypothetical Controlled in a Hypothetical D/355(e) Reorganization equal the basis and fair market value, respectively, of such property in the hands of Controlled immediately before the distribution of Controlled stock.

(B) Controlled stock that is Separated Property. The basis and fair market value of the stock of Controlled that is Separated Property treated as transferred by Distributing to a hypothetical Controlled in a Hypothetical D/355(e) Reorganization equal the basis and fair market value, respectively, of such stock in the hands of Distributing immediately before the distribution of Controlled stock.

(C) Anti-duplication rule. A Predecessor of Distributing's Separated Property is taken into account for purposes of applying this paragraph (e)(2) only to the extent such property was not taken into account by Distributing in a Hypothetical D/355(e) Reorganization with respect to another Predecessor of Distributing. Further, appropriate adjustments must be made to prevent other duplicative inclusions of section 355(e) gain under this paragraph (e) reflecting the same economic gain.

(3) Planned 50-percent Acquisition of Distributing in a section 381 transaction.

This paragraph (e)(3) applies if there is a Planned 50-percent Acquisition of Distributing (by application of paragraph (d)(1) of this section) that occurs as part of a Plan as the result of a transfer by a Predecessor of Distributing to Distributing in a section 381 transaction. In that case, the amount of gain recognized by Distributing by reason of section 355(e) as a result of the acquisition is the excess, if any, of the Statutory Recognition Amount, as applicable, over the amount of gain, if any, that Distributing would have been required to recognize under paragraph (e)(2) of this section if there had been a Planned 50-percent Acquisition of the Predecessor of Distributing, but not of Distributing, in the section 381 transaction. For purposes of this paragraph (e)(3), references to Distributing are not references to a Predecessor of Distributing.

(4) Overall gain recognition. The sum of the amounts required to be recognized by Distributing under section 355(e) and the regulations thereunder (taking into account paragraphs (e)(2) and (3) of this section) with regard to a single distribution will not exceed the Statutory Recognition Amount, as applicable. In addition, Distributing may choose not to apply the limitations of paragraph (e)(2) and (3) of this section to a distribution, and instead may recognize the Statutory Recognition Amount. Distributing indicates its choice to apply the preceding sentence by reporting the Statutory Recognition Amount on its original or amended Federal income tax return for the year of the distribution.

(5) Section 336(e) election. Distributing is not eligible to make a section 336(e) election with respect to a distribution to which this section applies unless Distributing would, absent the making of a section 336(e) election (as defined in §1.336-1(b)(11)), recognize the Statutory Recognition Amount with respect to a distribution of Controlled

stock under paragraph (e)(2), (e)(3), and (e)(4) (without regard to the final two sentences thereof) of this section. See §§1.336-1 through 1.336-5 for additional requirements with regard to a section 336(e) election.

(f) Predecessor or Successor as a member of the affiliated group. For purposes of section 355(e)(2)(C), if a corporation transfers its assets to a member of the same affiliated group (as defined in section 1504 without regard to section 1504(b)) in a section 381 transaction, the transferor will be treated as continuing in existence within the same affiliated group.

(g) Inapplicability of section 355(f) to certain intra-group distributions--(1) In general. Section 355(f) does not apply to a distribution if there is a Planned 50-percent Acquisition of a Predecessor of Distributing (but not of Distributing, Controlled, or their Successors), except as provided in paragraph (g)(2) of this section. Therefore, except as provided in paragraph (g)(2) of this section, section 355 (or so much of section 356 as relates to section 355) and the regulations thereunder, including the gain limitation rules of paragraph (e)(2) of this section, apply, without regard to section 355(f), to the distribution of Controlled within an affiliated group if the distribution and the Planned 50-percent Acquisition of the Predecessor of Distributing are part of a Plan. For purposes of this paragraph (g)(1), references to the distribution (and Distributing and Controlled) include references to a distribution (and Distributing and Controlled) to which section 355 would apply but for the application of section 355(f).

(2) Alternative application of section 355(f). Distributing may choose not to apply paragraph (g)(1) of this section to each distribution (that occurs under a single Plan) to which section 355(f) would otherwise apply absent paragraph (g)(1) of this section and

may instead apply section 355(f) to all such distributions according to its terms, but only if all members of the same affiliated group (as defined in section 1504(a) without regard to section 1504(b)) report consistently the Federal income tax consequences of the distributions that are part of the Plan (determined without regard to section 355(f)). In such a case, no gain limitation under paragraph (e)(2) or (3) of this section is available with regard to any applicable distribution. Distributing indicates its choice to apply section 355(f) consistently to all applicable distributions by reporting the Federal income tax consequences of each distribution in accordance with section 355(f) on its Federal income tax return for the year of the distribution.

(h) Examples. The following examples illustrate the principles of this section.

Unless the facts indicate otherwise, assume throughout these examples that:

Distributing (D) owns all the stock of Controlled (C), and none of the shares of C held by D has a built-in loss; D distributes the stock of C in a distribution to which section 355 applies, but to which section 355(d) does not apply; X, Y, and Z are individuals; each of D, D1, D2, C, P, P1, P2, and R is a corporation having one class of stock outstanding, and none is a member of a consolidated group; and each transaction that is part of a Plan defined in this section is respected as a separate transaction under general Federal income tax principles. No inference should be drawn from any example concerning whether any requirements of section 355 are satisfied other than those of section 355(e):

Example 1. Predecessor of Distributing--(i) Facts. X owns 100% of the stock of P, which holds multiple assets. Y owns 100% of the stock of D. The following steps occur as part of a Plan: P merges into D in a reorganization under section 368(a)(1)(A). Immediately after the merger, X and Y own 10% and 90%, respectively, of the stock of D. D then contributes to C one of the assets (Asset 1) acquired from P in the merger. At the time of the contribution, Asset 1 has a basis of \$40x and a fair market value of

\$110x. In exchange for Asset 1, D receives additional C stock and \$10x. D distributes the stock of C (but not the cash) to X and Y, pro rata. The contribution and distribution constitute a reorganization under section 368(a)(1)(D), and D recognizes \$10x of gain under section 361(b) on the contribution. Immediately before the distribution, taking into account the \$10x of gain recognized by D on the contribution, Asset 1 has an adjusted basis of \$50x under section 362(b) and a fair market value of \$110x, and the stock of C held by D has a basis of \$100x and a fair market value of \$200x.

(ii) Analysis--(A) Predecessor. Under paragraph (b)(1) of this section, P is a Predecessor of D. Immediately before the distribution and as part of a Plan, C holds P Relevant Property (Asset 1) the gain on which was not recognized in full as part of a Plan. Further, some of the C stock distributed in the distribution was acquired by D in exchange for Asset 1, and it reflects the basis of Separated Property (Asset 1). In addition, immediately after the distribution, D continues to hold Relevant Property of P. Therefore, P's Relevant Property has been divided between C and D.

(B) Acquisition of predecessor stock. Under paragraph (d)(1) of this section, Y is treated as acquiring stock representing 90% of the voting power and value of P as a result of the merger of P into D. Accordingly, there has been a Planned 50-percent Acquisition of P.

(C) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$100x of gain (\$200x of aggregate fair market value minus \$100x of aggregate basis of the C stock held by D), the Statutory Recognition Amount described in section 361(c)(2). However, under paragraph (e)(2) of this section, D's gain recognized by reason of the deemed acquisition of P stock will not exceed \$60x, an amount equal to the amount of gain D would have recognized had D transferred Asset 1 (Separated Property) to a newly-formed corporation (C1) solely for C1 stock and distributed the C1 stock to D's shareholders in a Hypothetical D/355(e) Reorganization. For purposes of this computation, the basis and fair market value of Asset 1 equal the basis and fair market value of Asset 1 in the hands of C immediately before the distribution of C stock. Under section 361(c)(2), D would recognize \$60x of gain, an amount equal to the gain in the hypothetical C1 stock (excess of the \$110x fair market value over the \$50x basis). Therefore, D recognizes \$60x of gain.

(iii) Plan not in existence at time of acquisition of Potential Predecessor's Property. The facts are the same as in paragraph (i) of this Example 1 except that the merger of P into D occurred before the existence of a Plan. Even though D transferred P property (Asset 1) to C, Asset 1 was not Relevant Property of P because P did not hold Asset 1 during the Plan Period. See paragraphs (b)(2)(iv) and (a)(4)(iii) of this section. Because Asset 1 is not Relevant Property, D did not receive C stock distributed in the distribution in exchange for Relevant Property when it contributed Asset 1 to C, none of the distributed stock reflects the basis of Separated Property, and C does not hold Relevant Property immediately before the distribution. Further, Relevant Property of P has not been divided. Therefore, P is not a Predecessor of D.

Example 2. Planned acquisition of Distributing, but not Predecessor of Distributing--(i) Facts. X owns 100% of the stock of P, which holds multiple assets. Y owns 100% of the stock of D. The following steps occur as part of a Plan: P merges into D in a reorganization under section 368(a)(1)(A). Immediately after the merger, X and Y own 90% and 10%, respectively, of the stock of D. D then contributes to C one of the assets (Asset 1) acquired from P in the merger. In exchange for Asset 1, D receives additional C stock. D distributes the stock of C to X and Y, pro rata. The contribution and distribution constitute a reorganization under section 368(a)(1)(D). Immediately before the distribution, Asset 1 has a basis of \$50x and a fair market value of \$110x, and the stock of C held by D has a basis of \$120x and a fair market value of \$200x.

(ii) Analysis--(A) Predecessor. Under paragraph (b)(1) of this section, P is a Predecessor of D. Immediately before the distribution and as part of a Plan, C holds P Relevant Property (Asset 1) the gain on which was not recognized in full as part of a Plan. Further, some of the C stock distributed in the distribution was acquired by D in exchange for Asset 1, and it reflects the basis of Separated Property (Asset 1). In addition, immediately after the distribution, D continues to hold Relevant Property of P. Therefore, P's Relevant Property has been divided between C and D.

(B) Acquisition of predecessor stock. Under paragraph (d)(1) of this section, Y is treated as acquiring stock representing 10% of the voting power and value of P as a result of the merger of P into D. The 10% acquisition of P stock does not cause section 355(e) gain recognition or cause application of paragraph (e)(2) of this section because there has not been a Planned 50-percent Acquisition of P. X acquires 90% of the voting power and value of D as a result of the merger of P into D. The acquisition of greater than 50% of the D stock implicates section 355(e) and results in gain recognition, subject to the rules of paragraph (e) of this section.

(C) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$80x of gain (\$200x of fair market value minus \$120x of basis of the C stock held by D), the Statutory Recognition Amount described in section 361(c)(2). However, under paragraph (e)(3) of this section, D's gain recognized by reason of X's acquisition of D stock will not exceed \$20x, the excess of the Statutory Recognition Amount (\$80x) over the amount of gain that D would have been required to recognize under paragraph (e)(2) of this section if there had been a Planned 50-percent Acquisition of the Predecessor of D but not D in the section 381 transaction (\$60x). The hypothetical gain under paragraph (e)(2) of this section equals the amount D would have recognized had it transferred Asset 1 (Separated Property) to a newly-formed corporation (C1) solely for stock and distributed the C1 stock in a Hypothetical D/355(e) Reorganization. Under section 361(c)(2), D would recognize \$60x of gain, an amount equal to the gain in the hypothetical C1 stock (excess of the \$110x fair market value over the \$50x basis). Therefore, D recognizes \$20x of gain (\$80x - \$60x).

Example 3. Predecessor of Distributing owns Controlled stock; gain duplication--(i) Facts. X owns 100% of the stock of P, which holds multiple assets, including Asset 2. Y owns 100% of the stock of D. P owns 35% of the stock of C (Block 1), and

D owns the remaining 65% of the C stock (Block 2). The following steps occur as part of a Plan: P merges into D in a reorganization under section 368(a)(1)(A), and D immediately thereafter distributes all of the C stock to X and Y pro rata. Immediately after the merger, X and Y own 10% and 90%, respectively, of the D stock, and, prior to the distribution, D owns Block 1 with a basis of \$40x and a fair market value of \$45x, and Block 2 with a basis of \$10x and a fair market value of \$65x. D continues to hold Asset 2.

(ii) Analysis--(A) Predecessor. Under paragraph (b)(1) of this section, P is a Predecessor of D. Some of the Controlled stock distributed in the distribution was Relevant Property of P, the gain on which was not recognized in full as part of a Plan. See paragraph (b)(1)(ii)(A)(2) of this section. This Controlled stock is Separated Property. See paragraph (b)(2)(vii) of this section. Because the gain on the P Controlled stock was not recognized in full, this stock reflects the basis of Separated Property. See paragraph (b)(1)(ii)(B) of this section. Because some of the Controlled stock distributed in the distribution was Relevant Property of P, C is deemed to have received Relevant Property of P. See paragraph (b)(1)(iii) of this section. Further, D continues to hold Relevant Property of P immediately after the distribution. Therefore, P's Relevant Property has been divided between C and D.

(B) Acquisition of predecessor stock. Under paragraph (d)(1) of this section, Y is treated as acquiring stock representing 90% of the voting power and value of P, as a result of the merger of P into D. Accordingly, there has been a Planned 50-percent Acquisition of P.

(C) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$60x of gain (\$110x of fair market value minus \$50x of basis of the C stock held by D), the Statutory Recognition Amount under section 355(c)(2). However, under paragraph (e)(2) of this section, D's gain recognized by reason of the deemed acquisition of P stock will not exceed \$5x, an amount equal to the amount D would have recognized had it transferred Block 1 of the C stock (Separated Property) to a newly-formed corporation (C1) solely for stock and distributed the C1 stock to D shareholders in a Hypothetical D/355(e) Reorganization. For purposes of this computation, the basis and fair market value of the Block 1 C stock equal their basis and fair market value in the hands of D immediately before the distribution of C stock. Under section 361(c)(2), D would recognize \$5x of gain, an amount equal to the gain in the hypothetical C1 stock (\$45x - \$40x). Therefore, D recognizes \$5x of gain.

Example 4. Controlled stock as Substitute Asset--(i) Facts. X owns 100% of the stock of P, which owns multiple assets, including 100% of the stock of R and Asset 2. Y owns 100% of the stock of D. The following steps occur as part of a Plan: P merges into D in a reorganization under section 368(a)(1)(A) (the P-D reorganization). Immediately after the merger, X and Y own 10% and 90%, respectively, of the stock of D. D then causes R to transfer all of its assets to C in a reorganization under section 368(a)(1) (the R-C reorganization). At the time of the P-D reorganization, the R stock has a basis of \$40x and a fair market value of \$110x. D distributes the stock of C to X

and Y, pro rata. D continues to directly hold Asset 2. Immediately before the distribution, the C stock held by D that was deemed received in the R-C reorganization has a basis of \$40x and a fair market value of \$110x, and all of the stock of C held by D has a basis of \$100x and a fair market value of \$200x.

(ii) Analysis--(A) Predecessor. Under paragraph (b)(1) of this section, P is a Predecessor of D. D is treated as acquiring a block of C stock in exchange for a direct or indirect interest in R stock (Relevant Stock) in the R-C reorganization because the basis of D in that C stock reflects the basis of the R stock. See paragraph (b)(2)(x) of this section. Further, because the block of C stock is treated as received in exchange for R stock, that block of C stock is a Substitute Asset, which is treated as Relevant Property. See paragraph (b)(2)(vi) of this section. Therefore, some of the C stock distributed in the distribution was Relevant Property of P, gain on which was not recognized in full as part of a Plan. This C stock is Separated Property. See paragraph (b)(2)(vii) of this section. Because the gain on P's R Stock (for which C stock is substituted) was not recognized in full, this C stock reflects the basis of Separated Property. See paragraph (b)(1)(ii)(B) of this section. Finally, under paragraph (b)(1)(iii) of this section, C is deemed to have received Relevant Property of P, and, immediately after the distribution, D continues to hold Asset 2, which is Relevant Property of P. Therefore, P's Relevant Property has been divided between C and D.

(B) Acquisition of predecessor stock. Under paragraph (d)(1) of this section, Y is treated as acquiring stock representing 90% of the voting power and value of P, as a result of the P-D reorganization. Accordingly, there has been a Planned 50-percent Acquisition of P.

(C) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$100x of gain (\$200x of fair market value minus \$100x of basis of all C stock held by D), the Statutory Recognition Amount described in section 355(c)(2). However, under paragraph (e)(2) of this section, D's gain recognized by reason of the deemed acquisition of P stock will not exceed \$70x, an amount equal to the amount D would have recognized had it transferred the C stock deemed received in the R-C reorganization under section (b)(2)(x) of this section (Separated Property) to a newly-formed corporation (C1) solely for stock and distributed the C1 stock to D shareholders in a Hypothetical D/355(e) Reorganization. Under section 361(c)(2), D would recognize \$70x of gain, an amount equal to the gain in the hypothetical C1 stock (excess of the \$110x fair market value over the \$40x basis). Therefore, D recognizes \$70x of gain.

Example 5. Predecessor of Distributing; section 351 transaction--(i) Facts. X owns 100% of the stock of P, which holds multiple assets, including Asset 1, Asset 2, and Asset 3. Y owns 100% of the stock of D. The following steps occur as part of a Plan: P transfers Asset 1 and Asset 2 to D and Y transfers property to D in an exchange qualifying under section 351. Immediately after the exchange, P and Y own 10% and 90%, respectively, of the stock of D. D then contributes Asset 1 to C in exchange for additional C stock. D distributes all of the stock of C to P and Y, pro rata.

D continues to directly hold Asset 2, and P continues to directly hold Asset 3. The contribution and distribution constitute a reorganization under section 368(a)(1)(D). Immediately before the distribution, Asset 1 has a basis of \$40x and a fair market value of \$110x, and the stock of C held by D has a basis of \$100x and a fair market value of \$200x. Following the distribution, and as part of the same Plan, Z acquires 51% of the P stock.

(ii) Analysis--(A) Predecessor. Under paragraph (b)(1) of this section, P is a Predecessor of D. Immediately before the distribution, and as part of a Plan, C holds P Relevant Property (Asset 1), the gain on which was not recognized in full as part of a Plan. Further, the C stock distributed in the distribution was acquired by D in exchange for an interest in P Relevant Property transferred to C, and the basis of the C stock reflects the basis of Separated Property (Asset 1). In addition, immediately after the distribution, each of P and D holds Relevant Property of P. Therefore, P's Relevant Property has been divided between C, on the one hand, and P and D on the other hand.

(B) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$100x of gain (\$200x of fair market value minus \$100x of basis of the C stock held by D), the Statutory Recognition Amount described in section 361(c)(2). However, under paragraph (e)(2) of this section, D's gain recognized by reason of Z's acquisition of P stock will not exceed \$70x, an amount equal to the amount D would have recognized had it transferred Asset 1 (Separated Property) to a newly-formed corporation (C1) solely for voting stock and distributed the C1 stock to D shareholders in a Hypothetical D/355(e) Reorganization. Under section 361(c)(2), D would recognize \$70x of gain, an amount equal to the gain in the hypothetical C1 stock (excess of the \$110x fair market value over the \$40x basis). Therefore, D recognizes \$70x of gain.

Example 6. Predecessor of Distributing; forward triangular merger--(i) Facts. X owns 100% of the stock of P, which owns multiple assets, including 100% of the stock of R and Asset 2. Y owns 100% of the stock of D. The following steps occur as part of a Plan: R merges into C in a reorganization under section 368(a)(1)(A) and (2)(D). Immediately after the merger P and Y own 10% and 90%, respectively, of the stock of D. D distributes the stock of C to P and Y pro rata. Immediately before the distribution, R's directly-held assets have a basis of \$40x and a fair market value of \$110x. Immediately before the distribution, D has a basis in the C stock of \$60x and a fair market value of \$200x. Pursuant to the same Plan, Z acquires 51% of P stock. P continues to hold Asset 2.

(ii) Analysis--(A) Predecessor. Under paragraph (b)(1) of this section, P is a Predecessor of D because immediately before the distribution, and as part of a Plan, C holds directly P Relevant Property (Underlying Property of R) the gain on which was not recognized in full as part of a Plan. Further, the C stock distributed in the distribution was acquired by D, in part, in deemed exchange for P Relevant Property (see paragraph (b)(2)(x) of this section), and the C stock reflects the basis of Separated Property (Underlying Property of R). See §1.358-6(c)(1). In addition, immediately after

the distribution, P's Relevant Property has been divided between C, on the one hand, and P and D on the other hand.

(B) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$140x of gain (\$200x of fair market value minus \$60x of basis of the C stock held by D), the Statutory Recognition Amount under section 355(c)(2). However, under paragraph (e)(2) of this section, D's gain recognized by reason of the 51% acquisition of P stock by Z will not exceed \$70x, an amount equal to the amount D would have recognized had it transferred the Underlying Property of R to a newly-formed corporation (C1) solely in exchange for stock and distributed the C1 stock to D shareholders in a Hypothetical D/355(e) Reorganization. Under section 361(c)(2), D would recognize \$70x of gain, an amount equal to the gain in hypothetical C1 stock (excess of the \$110x aggregate fair market value of the Underlying Property of R over the \$40x basis). Therefore, D recognizes \$70x of gain.

Example 7. Potential Predecessor in sequential distributions--(i) Facts. X owns 100% of P, which owns multiple assets, including Asset 1 and Asset 2. Y owns 100% of the stock of D, D owns 100% of the stock of D1, and D1 owns 100% of the stock of C. The following steps occur as part of a Plan: P merges into D1 in a reorganization under section 368(a)(1)(A). Immediately after the merger, X and D own 10% and 90%, respectively, of the stock of D1. D1 contributes Asset 1 to C in exchange for additional C stock, but D1 continues to hold Asset 2. D1 distributes the stock of C to D and X, pro rata in a distribution to which section 355 applies (First Distribution), and D distributes to Y all of the stock of C that it received from D1 in a distribution to which section 355 applies (Second Distribution). The contribution of Asset 1 by D1 to C and the First Distribution constitute a reorganization under section 368(a)(1)(D). Immediately before the First Distribution and the Second Distribution, Asset 1 has a basis of \$10x and a fair market value of \$60x, and the stock of C has a fair market value of \$200x. Immediately before the First Distribution, the stock of C held by D1 has a basis of \$100x. The stock of C held by D immediately before the Second Distribution has a basis of \$80x.

(ii) Analysis--(A) Predecessor in First Distribution. Under paragraph (b)(1) of this section, P is a Predecessor of D1. Immediately before the First Distribution, and as part of a Plan, C holds P Relevant Property (Asset 1), the gain on which was not recognized in full as part of a Plan. Further, the C stock distributed in the First Distribution was directly acquired by D1 in exchange for P Relevant Property, and it reflects the basis of Separated Property (Asset 1). In addition, immediately after the First Distribution, each of C and D1 continues to hold Relevant Property of P. Therefore, P's Relevant Property has been divided between C and D1.

(B) Predecessor in Second Distribution. Under paragraph (b)(1) of this section, P is not a Predecessor of D. Immediately before the Second Distribution, the stock of C distributed does not reflect the basis of Separated Property (Asset 1). Because there has been no Planned 50-percent Acquisition of D, C, or a Predecessor of D, there is no application of section 355(e) to the Second Distribution.

(C) Gain on First Distribution. By application of section 355(f), section 355 and the regulations thereunder (including the gain limitation rules in paragraph (e) of this section) would not apply to the First Distribution. Therefore, D1 would be required to recognize \$100x of gain (excess of the \$200x fair market value over the \$100x basis of C stock held by D1) under section 311(b), and D would be treated as receiving a distribution of \$180x to which section 301 applied. However, under paragraph (g)(1) of this section, section 355(f) will not apply to the First Distribution. As a result, section 355, including the gain limitation rules of paragraph (e)(2) of this section, will apply to the First Distribution. Under paragraph (e)(2) of this section, D1's gain recognized by reason of the deemed acquisition of P stock by D will not exceed \$50x, an amount equal to the amount D1 would have recognized had it transferred Asset 1 (Separated Property) to a newly-formed corporation (C1) solely for stock and distributed the C1 stock to D1 shareholders in a Hypothetical D/355(e) Reorganization. Under section 361(c)(2), D1 would recognize \$50x of gain, an amount equal to the gain in the hypothetical C1 stock (excess of the \$60x fair market value over the \$10x basis). Therefore, D1 recognizes \$50x of gain. Under paragraph (g)(2) of this section, however, D1 may choose to apply section 355(f) to the First Distribution, in which case D1 would recognize \$100x of gain under section 311(b) and section 301 would apply to the distribution of C stock to D.

Example 8. Sequential Predecessors--(i) Facts. X owns 100% of P1, which holds multiple assets, including Asset 1 and Asset 2. Y owns 100% of P2, which holds Asset 3, and Z owns 100% of D. The following steps occur as part of a Plan: P1 merges into P2 in a reorganization under 368(a)(1)(A). Immediately after the merger, X and Y own 10% and 90%, respectively, of the stock of P2. P2 then transfers Asset 1 to D and Z transfers property to D in an exchange qualifying under section 351. As a result of the exchange, P2 and Z own 10% and 90%, respectively, of the stock of D. D then contributes Asset 1 to C in exchange for additional C stock, and P2 retains Asset 2 and Asset 3. D distributes all of the stock of C to P2 and Z, pro rata. The contribution and distribution constitute a reorganization under 368(a)(1)(D), and D recognizes no gain under section 361. Immediately before the distribution, Asset 1 has a basis of \$40x and a fair market value of \$100x, and the stock of C held by D has a basis of \$100x and a fair market value of \$200x.

(ii) Analysis--(A) P2 as Predecessor of D. Under paragraph (b)(1) of this section, P2 is a Predecessor of D. Immediately before the distribution, and as part of a Plan, C holds P2 Relevant Property (Asset 1), the gain on which was not recognized in full as part of a Plan. Further, the C stock distributed in the distribution was acquired by D in exchange for a direct interest in P2 Relevant Property (Asset 1), and it reflects the basis in Separated Property (Asset 1). In addition, immediately after the distribution, P2 continues to hold P2 Relevant Property. Therefore, P2's Relevant Property has been divided between C and P2.

(B) P1 as Predecessor of D. Under paragraph (b)(1) of this section, P1 is a Predecessor of D. P1 transferred property to P2 (a Predecessor of D) as part of a Plan. Immediately before the distribution, and as part of a Plan, C holds P1 Relevant Property

(Asset 1) the gain on which was not recognized in full as part of a Plan. Further, the C stock distributed in the distribution was acquired by D in exchange for a direct interest in P1 Relevant Property, and it reflects the basis in Separated Property (Asset 1). In addition, immediately after the distribution, P2 (a successor of P1 under paragraph (b)(2)(iii) of this section) continues to hold Relevant Property of P1. Therefore, P1's Relevant Property has been divided between C and P2 (the successor of P1).

(C) Acquisition of predecessor stock. Under paragraph (d)(1) of this section, Y is treated as acquiring stock representing 90% of the voting power and value of P1 as a result of the merger of P1 into P2. Accordingly, there has been a Planned 50-percent Acquisition of P1. There is no acquisition of P2 stock.

(D) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$100x of gain (\$200x of aggregate fair market value minus \$100x of aggregate basis of the C stock held by D), the Statutory Recognition Amount described in section 361(c)(2), because there has been a Planned 50-percent Acquisition of P1, a Predecessor of D. However, under paragraph (e)(2) of this section, D's gain recognized by reason of the deemed acquisition of P1 stock will not exceed \$60x, an amount equal to the amount D would have recognized had it transferred Asset 1 (Separated Property) to a newly-formed corporation (C1) solely for stock and distributed the C1 stock to D shareholders in a Hypothetical D/355(e) Reorganization. Under section 361(c)(2), D would recognize \$60x, an amount equal to the gain in hypothetical C1 stock (excess of the \$100x fair market over the \$40x basis). The fact that there is no Planned 50-percent Acquisition of either P2 or D does not change this result. Therefore, D recognizes \$60x of gain.

Example 9. Multiple Predecessors of Distributing--(i) Facts. X owns 100% of the stock of P1, which holds multiple assets, including Asset 1 and Asset 3. Y owns 100% of the stock of P2, which holds multiple assets, including Asset 2 and Asset 4. Z owns 100% of the stock of D. The following steps occur as part of a Plan: each of P1 and P2 merges into D in a reorganization under section 368(a)(1)(A). Immediately after the mergers, each of X and Y owns 10%, and Z owns 80%, of the stock of D. D then contributes to C Asset 1 (acquired from P1), and Asset 2 (acquired from P2). In exchange for Asset 1 and Asset 2, D receives additional C stock. D distributes the stock of C to X, Y, and Z, pro rata. D's contribution of Asset 1 and Asset 2 and the distribution constitute a reorganization under section 368(a)(1)(D). D continues to hold Asset 3 and Asset 4. Immediately before the distribution, Asset 1 has a basis of \$50x and a fair market value of \$110x, Asset 2 has a basis of \$70x and a fair market value of \$90x, and the stock of C held by D has a basis of \$130x and a fair market value of \$220x.

(ii) Analysis--(A) Predecessor. Under paragraph (b)(1) of this section, each of P1 and P2 is a Predecessor of D. Immediately before the distribution and as part of a Plan, C holds P1 Relevant Property (Asset 1) and P2 Relevant Property (Asset 2), each of which was transferred as part of a Plan without full gain recognition. The C stock distributed in the distribution was acquired by D in exchange for Asset 1 and Asset 2, and that stock reflects the basis in both Asset 1 and Asset 2 (Relevant Property). In

addition, immediately after the distribution, D continues to hold Relevant Property of P1 and P2. Therefore, each of P1's and P2's Relevant Property has been divided between C and D.

(B) Acquisition of Predecessor stock. Under paragraph (d)(1) of this section, Z is treated as acquiring stock representing 80% of the voting power and value of each of P1 and P2 as a result of the mergers of P1 and P2 into D. Accordingly, there has been a Planned 50-percent Acquisition of P1 and P2.

(C) Gain limited. Without regard to the limitations in paragraph (e) of this section, D would be required to recognize \$90x of gain (\$220x of fair market value minus \$130x of basis of the C stock held by D), the Statutory Recognition Amount under section 361(c)(2). However, under paragraph (e)(2) of this section, D's gain recognized by reason of the deemed acquisition of P1 stock will not exceed \$60x (\$110x fair market value minus \$50x basis), an amount equal to the amount D would have recognized had it transferred Asset 1 (Separated Property) to a newly-formed corporation (C1) solely for stock and distributed that (C1) stock to D shareholders in a Hypothetical D/355(e) Reorganization. D's gain recognized by reason of the deemed acquisition of P2 stock will not exceed \$20x (\$90x fair market value minus \$70x basis), an amount equal to the amount D would have recognized had it transferred Asset 2 (Separated Property) to a second newly-formed corporation (C2) solely for stock and distributed the (C2) stock to D shareholders in a Hypothetical D/355(e) Reorganization. Therefore, D will recognize \$80x of gain (\$60x + \$20x).

Example 10. Successor of Controlled--(i) Facts. X owns 100% of the stock of each of D and R. The following steps occur as part of a Plan: D distributes all of its C stock to X. Immediately before the Distribution, D's C stock has a basis of \$10x and a fair market value of \$30x. C then merges into R in a reorganization under section 368(a)(1)(D). Immediately after the merger, X owns all of the R stock. As part of the same Plan, Z purchases 51% of the stock of R from X.

(ii) Analysis--(A) Successor. Under paragraph (c)(2) of this section, R is a Successor of C because after the distribution C transfers property to R in a section 381 transaction. Accordingly, under paragraph (d)(2) of this section, Z's acquisition of stock of R is treated as an acquisition of stock of C. Therefore, Z is treated as acquiring 51% of the stock of C.

(B) Gain not limited. The special gain limitation rules in paragraph (e)(2) or (3) of this section do not apply because there is not an acquisition of stock of D or a Predecessor of D. Therefore, because the distribution and Z's acquisition of a 51% interest in R are part of a Plan, D is required to recognize gain in the amount of \$20x (\$30x fair market value minus \$10x basis of the C stock held by D), the Statutory Recognition Amount under section 355(c)(2).

Example 11. Multiple Successors--(i) Facts. X owns 100% of the stock of both D and R. Y owns 100% of the stock of S. The following steps occur as part of a Plan: D distributes all of the C stock to X. Immediately after the distribution, D merges into R in

a reorganization under section 368(a)(1)(A). Following the merger, R merges into S in a reorganization under section 368(a)(1)(A). As a result of the merger of R into S, X and Y own 10% and 90%, respectively, of the S stock. Immediately before the distribution, D's C stock has a basis of \$10x and a fair market value of \$30x.

(ii) Analysis--(A) Successor. Under paragraph (c)(2)(i) of this section, R is a successor of D because, after the distribution, D transfers property to R in a section 381 transaction. Under paragraph (c)(2)(ii), S is also a successor of D because R (a successor of D) transfers property to S in a section 381 transaction.

(B) Acquisition of Successor Stock. Under paragraph (d)(1) of this section, there is no deemed acquisition of D stock as a result of the merger of D into R because X wholly owns the stock of D before the merger and wholly owns the stock of R after the merger. Under paragraph (d)(1) of this section, Y is treated as acquiring stock representing 90% of the voting power and value of R (Successor of D) as a result of the merger of R into S. Under paragraph (d)(2) of this section, an acquisition of the R stock is also treated as an acquisition of the D stock.

(C) Gain. The special gain limitation rules in paragraph (e)(2) or (3) of this section do not apply because there is not an acquisition of stock of D or a Predecessor of D. Therefore, because there is a Planned 50-percent Acquisition of R (Successor of D), D is required to recognize \$20x of gain (\$30x fair market value minus \$10x basis of the C stock held by D), the Statutory Recognition Amount described in section 355(c)(2).

(i) Effective/applicability date--(1) In general. Except as provided in paragraph (i)(2) or (3) of this section, this section applies to distributions occurring after **[INSERT DATE 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.

(2) Transition rule--(i) In general. Except as provided in paragraph (i)(3) of this section, this section does not apply to a distribution (as defined in paragraph (i)(2)(ii) of this section) that is--

(A) Made pursuant to a binding agreement in effect on or before **[INSERT DATE OF FILING FOR PUBLIC INSPECTION BY THE FEDERAL REGISTER]** and at all times thereafter;

(B) Described in a ruling request submitted to the Internal Revenue Service on or before **[INSERT DATE OF FILING FOR PUBLIC INSPECTION BY THE FEDERAL**

REGISTER]; or

(C) Described on or before **[INSERT DATE OF FILING FOR PUBLIC INSPECTION BY THE FEDERAL REGISTER]** in a public announcement or in a filing with the Securities and Exchange Commission.

(ii) Definition of distribution. For purposes of paragraphs (i)(2)(i) and (3) of this section, references to a distribution include a reference to a distribution and other related pre-distribution transactions that together effect a division of the assets of a Predecessor of Distributing. Therefore, for example, if a corporation would qualify as a Predecessor of Distributing under paragraph (b)(1) of this section, Distributing may claim the benefit of the transition rule of paragraph (i)(2) of this section only if all steps relevant to the determination of Predecessor of Distributing status are described in the binding agreement, ruling request, announcement, or filing described in paragraph (i)(2)(i) of this section.

(3) Exception. Notwithstanding paragraph (i)(1) or (2) of this section, Distributing and any affiliated group that it is a member of as of the beginning of the date on which a distribution (as defined in paragraph (i)(2)(ii) of this section) may apply this section in its entirety to that distribution if it occurs after November 22, 2004. However, under this paragraph (i)(3), taxpayers must consistently apply this section in its entirety to all distributions occurring after November 22, 2004, that are part of the same Plan.

(j) Expiration date. The applicability of this section expires on or before December 16, 2019.

John Dalrymple,
Deputy Commissioner for Services and Enforcement.

Approved: December 1, 2016.

Mark J. Mazur.
Assistant Secretary of the Treasury (Tax Policy).